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AUTUMN 1984
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A quarterly publication of the
SURVEY RESEARCH CENTER
Institute for Social Research
THE UNIVERSITY OF MICHIGAN

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ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis of this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

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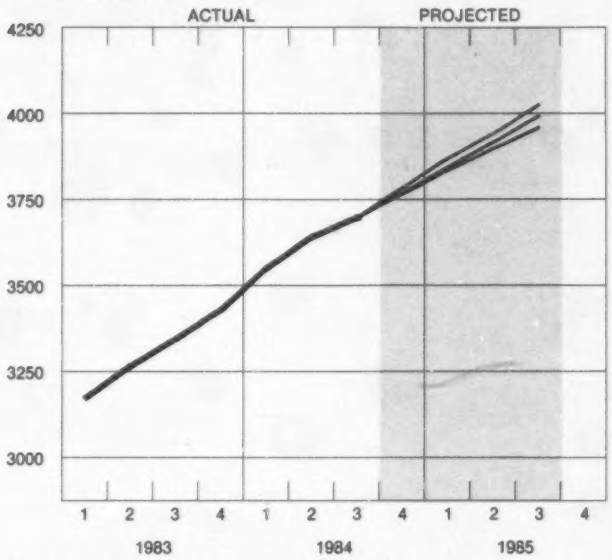
GROSS NATIONAL PRODUCT

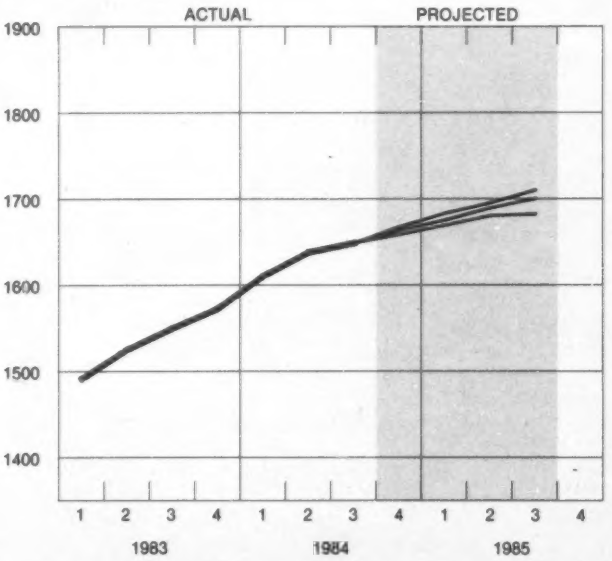
IN CURRENT DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

"Fairness" and Social Policy

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Director, Institute for Social Research
Professor of Economics
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The Liberal and Conservative Views

The recently concluded electoral campaign contained quite a bit of discussion on both sides about a subject called "fairness." On the Democratic side, Mr. Mondale charged that the social policies of the Reagan administration did not accord with principles of fairness, since they provided bigger tax breaks for the rich than for the middle class or the poor, weakened the safety net by cutting back eligibility standards for such means tested programs as food stamps and general welfare as well as for disability programs, threatened to reduce the level of future social security benefits for the elderly, and would try to cut Medicare and Medicaid programs. In general, the Mondale view of Reagan social policy is that it provides tax breaks and other advantages to the fortunate, while chipping away at the minimal public support levels provided to the less fortunate (with the chipping away process being limited only by the refusal of the Congress to go along).

The president and his supporters responded that economic opportunities reside in creating employment prospects in the private sector, not in enhancing the size of the public dole, that a program which brings vigorous economic recovery will do more for the less fortunate than any set of public programs that provide transfer payments, and that tax incentives for the rich will stimulate sufficient additional effort so that opportunities and outcomes for others will be enhanced in consequence.

The political rhetoric on both sides clearly reflects an argument about income distribution. Perhaps more importantly, it reflects very different world views about how the income distribution is generated, and the role played by incentives in creating both the distribution of income and influencing the growth rate of income. Is there anything that economists can say about these issues, other than to reflect their own values as citizens about what seems fair, equitable, and socially beneficial?

A Biblical Lesson

There are some things that economists and other social scientists know about these problems that can be put into the category of valid scientific knowledge and generalization rather than into the category of values and preferences. For example, one can talk sensibly about the degree to which income is generated by random chance, by systematically favorable or unfavorable circumstances unrelated to individual choice, or by individual effort, energy, and motivation. To take an extreme but simple case, let us examine the biblical tale of two brothers, both of whom received the same patrimony at the same "stage of career." One brother went on a revelry of wine, women and song, used up the patrimony in a couple of years, and returned penniless and clothed in rags. The other invested wisely, produced good crops, added to the original patrimony, and was a respected and productive member of the community.

Should they both be treated equally in terms of living standards? While the biblical tale is designed to show that charity should be shown to those who err, most people would probably say that the wasteful brother should suffer a penalty while the productive brother should be rewarded. After all, here we have a classic case of all other things being (roughly) equal: they both had similiar genes, since they are brothers; they both had a similiar upbringing, again because they are brothers; they presumably had the same education, if any; but one was consumption-oriented and the other investment-oriented, and as a result one had nothing after a couple of years and the other had more than he started with. Some would point out that everything wasn't necessarily equal—the wasteful one might have been badly and unfairly treated by the patriarch when he was young and developed a bad image of himself, thus leading to a process where continual negative feedback produces an attitude that one can do nothing right, so why try. The biblical story is silent on that possible source of difference.

Examples which fit the "other things roughly equal" illustration above do not come easily to mind, since we do not run controlled experiments in democratic societies. Nonetheless, we know quite a bit about the forces that play an important role in the distribution of income, and we also know quite a bit about the effect of various kinds of incentives on effort levels and outcomes. In none of these cases is the knowledge base perfect, in that we do not have identical individuals who differ only in some factor like motivation. But we can go some distance.

Factors Associated with Income

To begin with, it might be well to decide what factors associated with income are appropriately put into boxes like "random chance," "systematic good or bad fortune unrelated to individual choice," and "individual motivation, energy and effort." For example, what about family background? That seems a straightforward case of good or bad fortune, and certainly does not represent motivation, energy or effort. A person born into a family with high socio-economic status (reflecting income, educational attainment and occupation) and having a modest number of siblings is demonstrably better off in terms of earnings prospects than someone born into a family with low socio-economic status and a large number of siblings to compete for attention and resources. We can all find dozens if not hundreds of casual illustrations about the difference that family background makes among our own acquaintances and in our own experience.

What about educational attainment? There is an economic model that speaks of educational attainment as representing an investment of time and money (time by the student, money usually by the parent), where current income is foregone in order to enhance future earnings prospects. That current market earnings are foregone by students is not in question. But whether students have living standards that

are lower than they would otherwise be by virtue of their student status seems to me a highly questionable proposition. Going to school (certainly going to college, which is where most of the relevant differentiation occurs) is not appropriately characterized as a general condition where the student is giving up a great deal in order to get somewhat more later on. Student life is pretty pleasant for the most part, the student's parents usually help to sustain a living standard for him or her which is not dissimilar to their own, and it would be hard to make a persuasive case that people with higher educational attainment deserve more income "because they have earned it," as the saying goes. Some cases don't fit that generalization—there are young people who give up a good deal to get more schooling, by working nights and weekends, by giving up social life, and by putting in a great deal of additional effort. But the data suggest that this is not the typical case.

What about genetic endowment? That seems pretty straightforward: if you happen to be lucky enough to be born with a lot of brains, or with a lot of agility and a seven-foot height, you are quite apt to have a higher income than if you are born with an average or below average amount of brains and nothing exceptional in the form of physical attributes.

What about motivation? People certainly differ quite a lot in their striving for excellence, and in the amount of effort they put into whatever task they are currently undertaking. One might be inclined to attribute that to something about the individual—simply a desire to excel and a willingness to sacrifice in order to achieve excellence. But where does motivation come from? Probably to some extent out of the dynamics of childhood and young adult experience, and out of family values. To the extent that striving for excellence and hard work is derived from one's parents or one's circumstances, it is hard to see why that warrants individual rewards, other things being equal. And the causality between motivation and economic success may work in reverse from the Horatio Alger story, since success is certainly capable of producing motivation.

What the Data Have to Say

The general thrust of these speculations is clearly to suggest that a goodly share of success in life is not easily attributed to individual choices relating to effort, energy and motivation, but is more plausibly a consequence of factors over which the individual has little or no control. That is certainly true of random chance by definition, but appears to be true of a good many systematic forces as well.

If we turn to the data for illumination, we find some results that are helpful and others that are ambiguous. Economists have for decades estimated earnings functions for individuals, in an attempt to explain characteristics of the distribution of earnings as well as to understand the dynamics of various types of earnings trajectories that one observes. In these empirical studies, the factors that show up as being extremely important in determining individual earnings are the level of educational attainment, the socioeconomic status of the parents, ability as measured by some kind of IQ score, work effort as measured by hours worked annually, and occupation. Other factors that play a role in earnings functions are health status (especially poor health), religious preference (especially coming from a Jewish family and, to a lesser extent, a Catholic background),[1] and urbanicity (especially working and living in a large city). It is also true that these variables explain only a part of individual differences in earnings, and there is a substantial residual left over. And the residual (the part not explained by the forces just described) is serially correlated—that is, a person with a positive residual in one year is quite apt to have a positive residual in other years as well.[2] Finally, the data generally suggest that strong motivation is a consequence of success, not the other way around.

Most of the systematic forces that seem to impact on earnings thus seem to me wholly or largely in the category of systematic good or bad fortune. That is certainly true of family background, ability, educational attainment, health, and religious preference. It may also be true of work hours and occupation, although it is hard to tell because that depends on whether the hours and occupation are themselves a function of opportunity and motivation growing out of family background and training, or out of something else.

An interesting issue is how to interpret the very large residual. By definition, the residual is a level of achieved earning not explained by any of the factors just discussed. It could be simply random chance—some people wind up being lucky and others unlucky because of particular chance events. But it might be unobservable and systematic forces that are controlled by individuals—some people seize on opportunities and make the most of them, while others let them go by the board because they require too much effort to pursue. No doubt there is a bit of both involved, and social science in its current state of knowledge cannot really disentangle the part of the residual due to genuine random chance and the part due to differential ability to capitalize on chance events.

Incidentally, the serially correlated properties of the residual do not really help here even though it seems that they might. Since motivation and effort are not usually well-measured, if at all, in empirical studies, it might be thought that the residual is largely individual differences in motivation and effort. But an equally plausible explanation is that pure luck or chance factors result in earnings above or below those predicted by other factors, and that future earnings and economic opportunities are importantly influenced by past earnings and opportunities. Thus if one happens to be lucky enough to land a high-paying but scarce job by luck or chance (your brother-in-law works there and puts in a good word), the likelihood of those high earnings in that same scarce job continuing to exist are substantial, and could easily account for some of the observed serial correlation in the residual. Alternatively, the unexplained residual might be due to unobservable motivation and effort factors, but motivation and effort themselves might be attributable to background variables over which the individual has little or no control.

The residual may also help to explain another important phenomenon in the data—that there is a great deal of economic mobility in the U.S., despite the fact that many of the most important forces that determine economic success are ones likely to persist across generations (parental status, educational attainment, ability, health, etc.). But there is an important component of income that is not explained by these or other systematic factors, but by some combination of forces that can vary quite a lot across generations. Hence the observed mobility.

[1] Both Jewish and Catholic religious preference variables have a positive influence on earnings: so much for the Protestant Ethic!

[2] Positive serial correlation is the dominant case, but negative serial correlation is also observed.

The upshot is that while there is certainly some ambiguity about the relative importance of random chance, systematic good or bad fortune, and individual effort, the evidence suggests that the income distribution is dominated by factors that represent a subtle and not so subtle set of opportunities that differ widely among individuals but for which they deserve little credit. The evidence is not perfectly conclusive, and there is room for a substantial role for individual effort. But that role appears to be secondary to the role of other forces.

The Role of Incentives

Even if it were true that economic fortune was by and large due to favorable or unfavorable circumstances rather than factors under the control or individuals, it is still not necessarily the case that appropriate public policy should be designed to reward only differences in individual effort and not differences associated with accidents of birth or background. The reason is that incentives matter, regardless of whether or not rewards are justified by some set of ethical or fairness criteria. Taxing people on the basis of accidents of birth or circumstances may be justified on grounds of fairness, but if the tax is perceived as unfair and/or it diminishes people's willingness to work, it will have a negative impact on productivity and growth nonetheless. Moreover, incentives have to be considered as spanning across generations. If I invest in a college education for my children because I want them to be better off, what would taxes on my children's future income do to my incentives to invest in their education? They clearly wouldn't help.

Thus the evidence here supports earnings differential to a greater degree than what seems to me the case if one looks strictly at fairness as reflected by individually determine effort. There is some evidence that people respond to marginal tax rates in terms of work effort, although the response is relatively mild given the rhetoric about incentives and effort that sometimes dominates the discussion. (For example, there is no evidence at all that the extreme response predicted by hard-core supply-siders has any warrant in the empirical evidence about the effect of taxes on labor supply.) But there is some incentive effect, and it needs to be taken into account in designing policy.

Perhaps more importantly, there is persuasive evidence that people largely regard their own income as a reward for their own effort, and do not generally see their income status as a consequence of accidents of birth or of good luck generally. As an illustration, the widespread disaffection with the high inflation rate that characterized the decade of the 1970s is in part due to a generally held perception that large increases in money wage rates were a consequence of one's own effort and skill, while the equally large increases in prices were a consequence of the nefarious behavior of others. It was not generally perceived that both were due to the same cause, and that if inflation rates had been lower, money wage rate increases would also have been lower, and vice versa. In addition, studies of equity perceptions indicate that people are quite prepared to see individuals with more skill and training, or in jobs with greater risk, receive higher wage rates than their own, even though the greater amounts of skill or training might well have been the consequence of accidents of birth or family background. What is not perceived to be equitable will not work very well as public policy.

Income-Support Programs

An important public policy issue concerns the disincentive effects of various types of public programs designed to maintain some minimum consumption level for the poor, the elderly, and the generally disadvantaged. The common stereotype is that welfare programs of any sort beget dependency, and that not ony does a welfare program tend to perpetuate itself, but that dependency is passed on from one generation of welfare recipients to the next.

There is a fair amount of evidence to assess those concerns. Surprisingly enough, it turns out that the stereotypes are basically inconsistent with the data. The great bulk of welfare recipients are on welfare only temporarily—the average is about two years, and fewer than ten percent of welfare recipients are long-term welfare dependents; most people who are on welfare also work, and the work part of their income is more important than the welfare part; and perhaps most surprising of all, there is little evidence that welfare dependency is transmitted across generations—among blacks, the odds that a black child raised in a welfare-dependent household will himself or herself be on welfare are about the same as the odds that a black child raised in a nonwelfare-dependent household will be on welfare! Interestingly enough, it is among whites that one can find some (slight) evidence that welfare dependency is transmitted from one generation to the next. Unfortunately, hardly anyone in the political arena understands these basic facts about welfare dependency, and the conventional stereotypical view tends to dominate the discussion.

Conclusions

What does all this tell us about fairness? The answer is something, although not everything. If there were an earnings function created by an Omniscient Analyst, it would then be possible to separate out random chance, good fortune, and effort, and assign appropriate weight to all three. In the absence of such a study, about all we can say is that good fortune by virtue of who your parents are and what your opportunities consist of will make a good deal of difference in how well-off you are, and it matters some whether you are energetic or lazy about pursuing opportunities. My own guess is that the great bulk of the variation in observed income is attributable either directly or indirectly to circumstances, and not much of it is attributable either directly or indirectly to genuine individual choice that is not in turn strongly influenced by circumstances. If that is so, one would come down more on the side of the liberal world view, as described above, than on the side of the conservative world view. And if it is also true that the adverse incentive effects of support programs like food stamps, general welfare, supplemental security income, disability benefits, etc. are neither large nor typically permanent, and the adverse disincentive effects of progressive income taxation (at reasonable rates) are also modest in size, that would strengthen a preference for a more charitable view of human motivation and a more supportive view of dependency programs designed to put a floor under the least advantaged part of the population. But the evidence is not unambiguously clear, and there is certainly room for at least the milder versions of conservative concern over disincentive effects as well as over the interpretation of equity and fairness.

Financial Gains Bolster Consumer Confidence

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Optimism Maintained at Record Level

In the third quarter 1984 survey, the Index of Consumer Sentiment was 98.9, just between the 96.6 recorded one quarter earlier and the cyclical peak of 99.5 recorded in the first quarter of 1984. Consumer sentiment has been more favorable thus far in 1984 than in any prior year during the past decade.

The improvement in consumer sentiment during the past few years has been substantial and widespread among major population subgroups. Since the 1980 all-time low, the Index of Consumer Sentiment has nearly doubled, rising from just over 50 to just under 100. The rapid pace of improvement recorded in late 1982 and early 1983 was based on very optimistic prospects for future economic gains. By the start of 1984, consumers' assessments of current economic conditions also reached record favorable levels. The major factor underlying both the initial improvement and the subsequent maintenance of evaluations at record levels has been sustained declines in inflation.

Prospects for the Economy: Good Times Despite Slower Growth

More families reported their awareness of an improved national economy in 1983 and 1984 than following any of the prior recessions during the past thirty years. Approximately two-thirds of all families reported in each of the quarterly surveys conducted since mid-1983 that economic conditions in the nation as a whole had improved over those which prevailed one year earlier. In the third quarter 1984 survey, 67 percent reported improved economic conditions, just below the all-time high of 71 percent recorded in the first quarter of 1984.

The rapid pace of economic growth recorded during the first half of 1984, as well as the recent slowdown in the growth rate, were not unexpected. Prospects for improvement in the aggregate economy as reported by consumers reached their most favorable level early in 1983. At that time, half of all consumers expected the national economy to improve during the year ahead. In the most recent survey, the proportion of families that expected continued economic growth fell to 33 percent. Importantly, few consumers expected the economy to actually worsen during the year ahead, rising to just 14 percent in the third quarter of 1984 from 9 percent one year earlier.

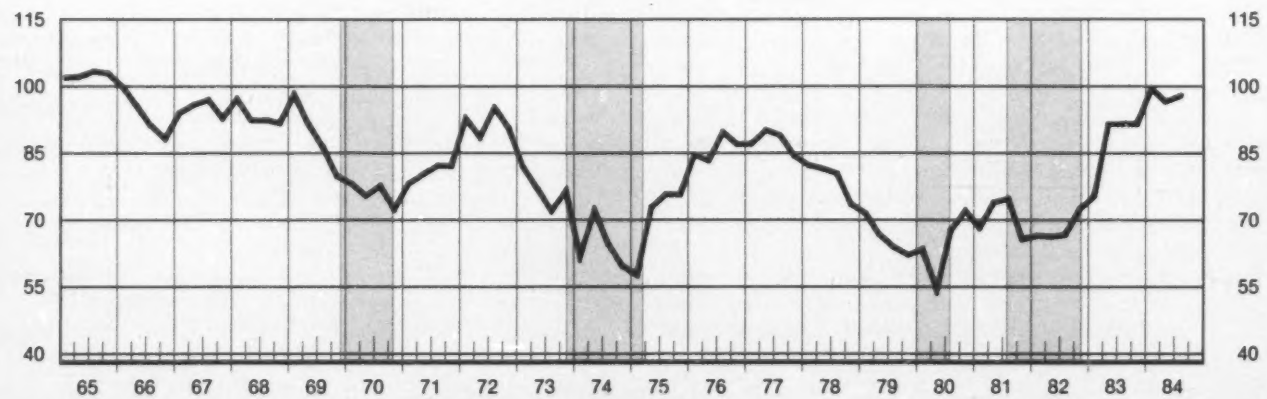
Despite a slowing rate of economic growth, good times financially in the economy as a whole were expected to prevail in both the near and longer terms. In the third quarter 1984 survey, 63 percent of all families expected good times financially in the economy as a whole during the upcoming year, just below the peak of 69 percent recorded in the first quarter of 1984. When asked about economic prospects over the next five years, 46 percent of all families expected good times financially, up from 38 percent one year earlier, and the highest level that has been recorded in more than a decade.

No Further Reductions in Unemployment Expected

The rapid improvement in assessments of the national economy recorded more than one year ago was propelled by expected declines in inflation, unemployment, and interest rates. Since that time, expectations about these three important economic factors have no longer improved in unison.

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Unemployment expectations reached their most favorable cyclical level in the second quarter of 1983 and have since then declined. Among all families in the third quarter 1984 survey, 25 percent expected unemployment to decline during the year ahead, down from the favorable peak of 40 percent recorded in the second quarter of 1983. The proportion of families that expected increases in the rate of unemployment rose to 21 percent in the third quarter 1984 survey, up from a low of 15 percent in the second quarter of 1983. Importantly, the majority (52 percent) now expect the unemployment rate to remain largely unchanged during the year ahead at its current level, rather than to increase.

Price expectations have declined considerably during the past several years, from a high of 11.9% at the start of 1980 to a low of 4.3% at the start of 1983. Price expectations have remained largely unchanged since then at those low levels. In the third quarter of 1984, consumers expected the annual inflation rate to average 4.4%. The cumulative four year change has been quite dramatic: in 1980, nearly three-quarters of all families expected inflation to average 5% or more; in contrast, by 1984, nearly three-quarters of all families expected inflation to average 5% or less.

Interest rate expectations reached their most favorable level earlier than inflation and unemployment expectations, in late 1982, and have since then worsened to a significant extent. In the third quarter 1984 survey, 55 percent of all families expected interest rate increases during the year ahead, compared with just 13 percent that expected interest rate declines. This represents only a small improvement over the bleak assessments recorded in the second quarter, when 66 percent expected increases.

In the third quarter 1984 survey, confidence in government economic policies to reduce inflation and unemployment reached its most favorable level during the last decade. Among all families, 33 percent favorably rated government economic policies, up from 27 percent one year earlier, and 18 percent two years earlier. Unfavorable evaluations of economic policies were given by 19 percent of all families in the third quarter of 1984, down from 22 percent one year earlier, and 33 percent two years earlier.

Personal Finances: Best in Decade

The financial situation of American families has substantially improved during the past several years. By the start of 1984, the highest proportion of families in more than a decade reported that their financial situation had improved, and since then the proportion has remained unchanged at that very favorable level. In the third quarter 1984 survey, 45 percent of all families cited recent improvement in their financial situation, nearly twice the 23 percent that reported financial reversals. These very favorable evaluations stand in sharp contrast to four years earlier, when the all-time low was recorded in the second quarter of 1980. Instead of the current favorable margin of nearly two-to-one, nearly twice as many families reported financial reversals rather than improvements at that time (25 versus 48 percent).

The substantial improvement during the past several years has been due to steady declines in inflation and, more recently, to increases in household income and employment. The proportion of families that complained about declines in the purchasing power of their income due to inflation fell steadily from its all-time peak of 46 percent at the end of 1979 to just 12 percent in the third quarter of 1984, the lowest level recorded in a decade. In contrast to the sustained decline in inflation, trends in family incomes at first briefly improved, then declined sharply from renewed recession and record setting unemployment. Reports of actual income declines rose sharply in 1982, reaching a 20-year peak of 24 percent by the start of 1983. The proportion of families that reported income declines has fallen since then to just 13 percent in the most recent survey. During that same time, reports of income increases rose from 27 to 36 percent in the third quarter 1984 survey.

The recent improvement in their financial situation was widely expected in advance by consumers, as recorded in the surveys conducted during the prior year. It was in the second quarter of 1983 that personal financial expectations first reached record favorable levels, when 40 percent of all families expected an improved financial situation during the following year. Since that time, personal financial expectations have remained largely unchanged at those favorable levels. In the third quarter 1984 survey, 37 percent expected to be better off financially, compared with just 9 percent that expected their financial situation to worsen during the year ahead. In contrast, the most unfavorable outlook for personal finances ever recorded in these surveys occurred in the second quarter of 1979, when more families expected their financial situation to worsen rather than to improve (29 versus 21 percent). Since that time, personal financial prospects have improved steadily through two recessions with only small reversals in overall trend.

The sustained improvement in the outlook for personal finances has been primarily due to expected declines in inflation, not to larger expected income increases. The same proportion of families in the most recent survey as four years earlier expected to receive income increases during the following year—64 percent. Although the number of families expecting increases has remined unchanged, the size of the expected increases has not. At the 1980 lowpoint, income increases of 6% or more were expected by 44 percent, which subsequently fell to 34 percent in the most recent survey. At the same time, the proportion of families that expected smaller income increases—under 6%—rose from 14 to 25 percent. Despite the decline in the size of the expected increase, the expected declines in inflation were even sharper. For example, although 44 percent of all families expected income increases of 6% or more in 1980, at the same time 48 percent of all families also expected an annual inflation rate of 6% or higher. In contrast, in the third quarter of 1984, when 34 percent expected income increases of 6% or more, just 20 percent of all families expected prices to increase by that much. At the present time, two-thirds of all American families expect their income to keep pace with or exceed the rate of inflation during the year ahead.

The cumulative improvements recorded in their financial situation during the past few years have led consumers to view longer-term trends more favorably in 1984 than any other time during the prior decade. In the third quarter survey, 60 percent of all families reported that their financial situation had improved compared with five years earlier, the highest proportion of families to report financial progress since 1972. Prospects for an improved financial situation during the next five years were also at decade high levels in 1984. In the third quarter, 53 percent of all families expected their financial situation to improve during the next five years, unchanged from the start of 1984, and the highest proportion recorded since 1972. Just 10 percent of all families in the most recent survey expected their financial situation to worsen, on balance, during the next five years.

Buying Attitudes Remain Favorable

Attitudes toward buying conditions for large household durables have remained largely unchanged at very favorable levels since the start of 1984. Among all families in the third quarter 1984 survey, 71 percent favorably rated buying conditions for durables, just below the all-time peak of 72 percent recorded in the second quarter. The primary reason for these very positive attitudes has been favorable perceptions of market prices for household durables. In the third quarter 1984 survey, 34 percent of all families mentioned the appeal of price discounts, compared with just 10 percent that mentioned their aversion to recent price increases on household durable goods. Unfortunately, the 33 percent of all families that referred to availability of lower prices represents a decline from 40 percent at the start of 1984, which was the highest level recorded during the past two decades. Thus far, however, the shift has been limited to the decline in the availability of discounted prices, since complaints about increased prices for durables have remained relatively infrequent during the past year—at about 10 percent.

Attitudes toward buying conditions for vehicles have remained near cyclical peak levels since the second quarter of 1983. Favorable car buying attitudes were held by 60 percent of all families in the third quarter of 1984, just below the 64 percent recorded six months and one year earlier. These small declines during the past year have been due to less frequent references to price discounts and rebates, cited by 21 percent of all families in the recent survey, down from 26 percent one year earlier. Favorable references to buying-in-advance of rising vehicle prices rose to 19 percent in the third quarter 1984 survey, up from 13 percent one year earlier. In addition, fewer consumers referred to the availability of reduced interest rates on vehicle loans in the third quarter 1984 survey (19 percent) than one year earlier (33 percent).

Favorable attitudes toward buying conditions for homes reached cyclical peak levels in the second quarter of 1983, and have since declined, but on balance remain favorable. Among all families in the third quarter 1984 survey, 50 percent favorably rated buying conditions for houses, down from 59 percent one quarter earlier, and the peak of 64 percent recorded in the second quarter of 1983. The major reason for the recent decline in favorable home buying attitudes has been interest rate increases. Among all families, 22 percent referred to the availability of lower mortgage interest rates in the third quarter 1984 survey, down from 36 percent one year earlier. Reflecting the recent small improvements in rate expectations, references to buying-in-advance of rising mortgage rates fell to 13 percent in the third quarter, down from a peak of 20 percent recorded one quarter earlier. At the same time, complaints about high mortgage rates rose to 38 percent in the third quarter from 27 percent in the second quarter.

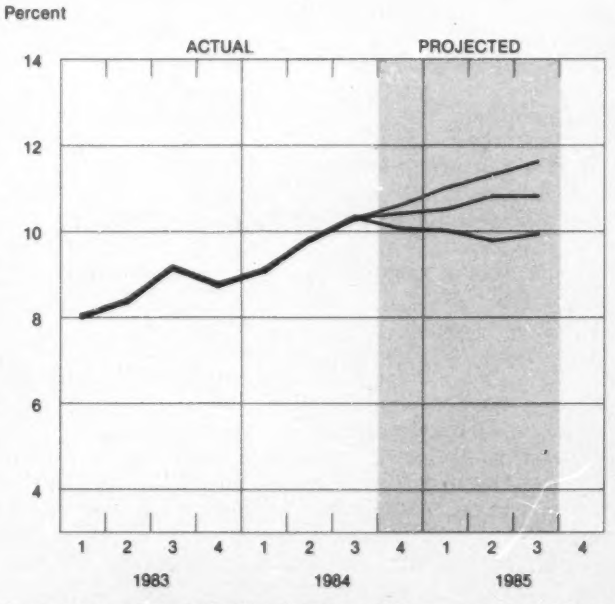
Summary Outlook

The speed, extent, and length of the current recovery in consumer attitudes and expectations have been distinctive. By the start of 1983, the dominant characteristic was the very rapid growth in favorable attitudes and expectations. By the start of 1984, the focus shifted to the extent of the recovery, as optimism reached record levels. Now, as we near the end of 1984, the prolonged length of time that sentiment has remained at very favorable levels has become its most distinctive aspect. These trends point toward the maintenance of consumer spending at high levels through 1984 and into 1985.

How will trends in consumer attitudes and expecations evolve during the year ahead? It would be easy to suggest that the year-long record levels of optimism cannot be long maintained; but this would be misleading. To be sure, the most recent surveys indicate that economic prospects have tilted toward a slower pace of improvement, and interest rate increases have dulled otherwise favorable buying attitudes. But no evidence has yet been recorded to indicate that the slowdown is expected to lead to a recession during the year ahead. Rather, the evidence suggests that consumers expect an extended period of slow growth, but nonetheless favorable economic conditions. Persistently high interest rates are viewed by consumers as the primary restraint on more vigorous growth.

November 1984

3-MONTH TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Business Economists Favor Reaganomics but Still Expect Recession Within 18 Months

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The tenth in the series of quarterly surveys of National Association of Business Economists (NABE) members was conducted in early September. Respondents were asked to forecast various economic series and to give their opinions about current economic policy matters. For analytical purposes, the business economists were classified according to their primary affiliation in six groups, some of which were changed from those used in prior surveys. The redefined groups are (1) manufacturing, mining, agriculture, forestry, or construction; (2) wholesale or retail trade, public utilities, transportation, or communications; (3) nonbank financial; (4) commercial banking; (5) academic or government; and (6) consulting or other not elsewhere classified.

Conditions in Company/Industry

Throughout the survey program, economists affiliated with a business firm have been asked about quarterly trends in various economic aspects of their own company or industry. The September survey focused on those economists affiliated with firms in groups 1 and 2, above; we will refer to them here as "manufacturing" and "trade/transport."

Results from the September survey are displayed in Table 1 and once again are generally consistent with the continuing economic expansion experienced during the three months preceding the survey:

- Demand had been increasing in more than half the companies and falling in only about a tenth, with the more vigorous expansion being reported by the trade/transport group.
- Employment had been stable in nearly 60 percent of firms, with rising employment having been somewhat more prevalent in the manufacturing group.
- Inventories had been increasing in 40 percent of the manufacturing firms and stable in about the same proportion, but less than 20 percent of trade/transport economists reported rising inventories, while over a third reported falling inventories.
- Real capital outlays had been rising in nearly 60 percent of the manufacturing firms and stable in more than a third; the proportions were substantialy reversed for the trade/transport firms, and here 17 percent reported falling outlays.
- Profit margins had been going up in only about a quarter of the manufacturing firms and stable in about three-fifths, while nearly half of the trade/transport companies experienced rising profits.
- Prices had increased in less than a quarter of firms in both groups and had been stable in close to 60 percent, though the trade/transport group reported a bit more inflation.
- Wages and salaries had been rising in roughly 35-40 percent of both groups and stable in something like 60 percent, with virtually no one reporting falling compensation. Again, slightly more inflation in wages and salaries was reported by respondents affiliated with trade, transport, etc.

TABLE 1. Trend in Various Economic Aspects of Respondent's Company or Industry During Three Months Prior to September 1984 Interview (Percentage Distribution)

Economic Aspect	Rising	Same	Falling
Unit Volume of Demand			
Manufacturing, etc.*	53	36	11
Trade, Transport, etc.	65	23	12
Employment			
Manufacturing, etc.	30	59	11
Trade, Transport, etc.	21	59	21
Unit Volume of Inventories			
Manufacturing, etc.	40	39	21
Trade, Transport, etc.	18	47	35
Real Capital Outlays			
Manufacturing, etc.	59	37	4
Trade, Transport, etc.	37	47	17
Profit Margins			
Manufacturing, etc.	27	62	11
Trade, Transport, etc.	46	36	18
Prices Charged			
Manufacturing, etc.	14	62	24
Trade, Transport, etc.	23	56	21
Wage Rates & Salaries			
Manufacturing, etc.	34	66	0
Trade, Transport, etc.	42	55	3

*The first group consists of respondents who said their primary affiliation was with manufacturing, mining, agriculture, forestry, or construction. The second group consists of those who placed themselves in wholesale or retail trade, public utilities, transportation, or communications.

These aggregate trends were different in some respects from those reported in the previous (May 1984) survey: prior to September, demand and employment had been increasing in a smaller proportion of firms, inventories were more likely to have been stable or falling, capital outlays were somewhat more likely to have been rising, and profit margins were less likely to have been rising. Prices charged were substantially less likely to have been rising, but prices paid to labor showed trends rather similar to those reported in May.

Economic Forecasts

Table 2 displays the median values of forecasts made in May and September for selected economic series. Real GNP was expected to increase by close to 6½ percent from 1983:4 to 1984:4 and by close to 7 percent for the full year 1984 compared with 1983; both values were subtantially higher

TABLE 2. Forecasts of Selected Economic Series, May 1984 & September 1984

Series	Median Value	
	May 84	Sept. 84
Annualized Percent Change:		
Real GNP		
1983:4-1984:4	4.92	6.40
Year 1983-Year 1984	5.73	6.87
1984:4-1985:4	–	3.12
Year 1984-Year 1985	3.41	3.60
Consumer Price Index		
1983:4-1984:4	5.19	4.18
Year 1983-Year 1984	4.97	4.07
1984:4-1985:4	–	5.36
Year 1984-Year 1985	5.99	5.02
Real Fixed Investment		
1983:4-1984:4	10.13	17.13
Year 1983-Year 1984	12.85	19.79
Year 1984-Year 1985	7.93	10.05
Corporate Profits		
Year 1984-Year 1985	–	8.12
Percent:		
Unemployment Rate		
1984:4	7.43	7.11
Year 1984	7.93	7.46
Year 1985	–	7.16
Prime Rate		
12/31/84	13.04	13.50
6/30/85	–	13.87
12/31/85	–	13.77
Millions of Units:		
New Private Housing Starts		
1984:4	1.70	1.68
Year 1984	1.80	1.80
Year 1985	1.60	1.60
Automobile Sales		
1984:4	10.11	10.57
Year 1984	10.14	10.76
Year 1985	–	10.26

Note: Dash indicates forecast not asked for in May

than the ones given in the May survey. The business economists expected GNP growth to taper off substantially in 1985, to about 3.1 percent in a fourth-quarter-to-fourth-quarter comparison and 3.6 percent in the year-over-year measure (the latter was fairly close to the analogous May forecast). Consumer prices were forecast to increase in 1984 by a bit over 4 percent fourth quarter to fourth quarter and year over year, both estimates being about a percentage point lower than the ones given in May. Price change was expected to accelerate in 1985 to about 5⅓ percent fourth quarter to fourth quarter and 5 percent year over year – the latter figure still about a percentage point lower than the May forecast. Real fixed investment was foreseen to increase by a bit more than 17 percent from 1983:4 to 1984:4 and by nearly 20 percent year over year – both estimates about 7 percentage points higher than the ones given in May. But the increase in real investment was expected to moderate to the 10 percent range from 1984 to 1985, still higher than but substantially closer to the previous estimate. The 1984-85 change in corporate profits was asked for the first time in the September survey; about an 8 percent increase was forecast.

The business economists predicted that the unemployment rate would drop to about 7.1 percent by the fourth quarter of this year and would average about 7½ percent for the year as a whole; these estimates were both somewhat lower than the May ones. For 1985 the average unemployment rate was forecast to be 7.16 percent. The prime rate was expected to climb to 13½ percent by year end (about half a percentage point higher than the May prediction) and then further to about 13.9 percent by mid-1985. It then was expected to drop slightly during the second half of next year. In view of recent declines in interest rates, these projections may be somewhat high.

New private housing starts were expected to average close to 1.7 million units during the fourth quarter and 1.8 million units during the full year 1984; for the full year 1985 they were expected to decline to the 1.6 million level. These three projections were virtually identical to the analogous ones given in the May survey. Automobile sales were forecast to average about 10.6 million units in 1984:4 and about 10¼ million units for the full year 1984, both estimates 5-6 hundred thousand higher than those in May. Sales were expected to decline by about half a million units from 1984 to 1985.

Few systematic differences were apparent among the forecasts give by economists in the six affiliation groups. Typically, respondents in each group were low on some series and high on others; the only somewhat consistent pattern was within the academic/government group, which for 1985 forecast higher consumer price change, higher unemployment, lower housing starts, lower car sales, and lower corporate profit increase than all other groups.

The two regional forecast questions asked in several previous surveys were repeated in the September survey, with the business economists being asked whether the overall economic growth rate and the unemployment rate in their part of the country would be higher than, lower than, or about the same as the national rate during the next 12 months. Concerning real GNP growth, about half the respondents in the South and West expected faster-than-average change, followed by about a third in the Northeast and only about a seventh in the North Central region. Fully half in that region expected slower-than-average growth. The expectations about unemployment seemed not entirely consistent with those about GNP. While the North Central area remained clearly the region with the most pessimistic expectations – 82 percent of economists there anticipated higher-than-average unemployment – more than half the respondents in the West also expected higher-than-average joblessness. Those in the Northeast and the South were rather similar in their expectations, with about 20 percent expecting relatively higher unemployment and around 60 percent expecting relatively lower unemployment.

Several new questions regarding longer-run projections of change in real GNP, productivity, and consumer prices were asked in the September survey. The business economists were asked to forecast the highest feasible, lowest feasible, and most likely change in the three series for the five-year period 1983-88. The results are displayed in Table 3.

TABLE 3. Five-Year Forecasts of Change in Real GNP, Productivity, and Consumer Prices

Series	Median Annualized Percent Change
Real GNP, 1983-88	
Highest	4.39
Lowest	1.99
Most Likely	3.34
Productivity, 1983-88	
Highest	3.35
Lowest	0.94
Most Likely	2.28
Consumer Prices, 1983-88	
Highest	7.74
Lowest	3.40
Most Likely	5.47

Highest expected real GNP growth was about 4.4 percent, lowest expected was about 2 percent, and most likely about 3⅓ percent. The figures for productivity growth were each about one percentage point lower than these. Highest projected consumer price change was about 7¾ percent, lowest was 3.4 percent, and most likely was about 5½ percent.

Two affiliation groups showed some consistent deviations from these aggregate median values. Economists in nonbank financial institutions gave the highest forecasts for all three productivity estimates and the lowest forecasts for two of the three consumer price change estimates. Academic and government economists gave consistently low estimates for real GNP and productivity; they also predicted the highest "high" value for consumer price change.

Fiscal and Monetary Policy

As in all previous surveys, the business economists were asked about recent fiscal and monetary policy. Trends over the past four surveys in their assessment of the appropriateness of fiscal and monetary policy are displayed in Table 4. The distribution of opinion about fiscal policy has been virtually unchanged since the February 1984 survey, with the overwhelming consensus having been that it was too stimulative. The proportion of business economists subscribing to that view ranged from about two-thirds in manufacturing to 97 percent in commercial banking.

TABLE 4. Trends in Opinions about Fiscal and Monetary Policy, November 1983-September 1984 (Percentage Distribution)

Opinion	Nov. '83	Feb. '84	May '84	Sept. '84
Fiscal Policy:				
Too Stimulative	73	82	83	82
About Right	22	14	14	15
Too Restrictive	5	4	3	3
Monetary Policy:				
Too Stimulative	3	3	12	4
About Right	82	78	74	85
Too Restrictive	15	19	14	11

The questions were "What is your view about current fiscal policy—is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions—have they been too stimulative, too restrictive, or about right?"

Two other questions relating to fiscal policy were posed in the September survey. Respondents were asked to give an estimate of federal budget deficits for fiscal years 1984 and 1985. The aggregate prediction for FY 1984 was $174.5 billion, ranging from a low of $171.9 billion from the commercial banking group to a high of $180 billion from the academic/government group. For FY 1985 the overall forecast was $179.7 billion, with a low of $175 billion given by the consultants and a high of $184.8 billion given by the economists in trade, transport, etc. Both aggregate forecasts were a few billion dollars lower than the analogous ones offered in the May survey.

Another question solicited the economists' best advice for the next administration regarding fiscal policy, to be selected from a list of several items. About two-fifths advised "reduc[ing] currently-planned future government spending without raising taxes." Another fifth suggested "broaden[ing] the tax base for personal income taxes and lower[ing] marginal tax rates." Ten percent favored "introduc[ing] a value-added tax or new excise taxes." The other responses were scattered among such suggestions as "impose a surcharge on personal and corporate income taxes" and "replace the current personal income tax with consumption taxes."

Among the affiliation groups, those in commercial banking most favored reducing spending (58 percent), those in nonbank finance most supported broadening the tax base and lowering tax rates (27 percent), those in trade/transport most supported the value added or excise tax (17 percent), those in consulting most favored imposing a tax surcharge (14 percent), and those in academe or government most favored a consumption tax (11 percent).

Concerning recent monetary policy, the September survey indicated a reversion toward the opinion expressed in the November 1983 and February 1984 surveys, in which about 80 percent viewed it as about right and most of the remainder said it was too restrictive. There were no significant differences among economists in the various affiliation groups here. In the context of the four surveys displayed in Table 4, the slight shift observed in May toward the "too stimulative" position seems to have been a temporary aberration.

Duration of the Current Expansion and Other Issues

As in all 1984 surveys, the business economists were asked about the duration of the current expansion. Specifically, they were asked "in what year and quarter do you expect the current expansion to peak?" Results are displayed in Table 5, consolidated into half-year periods for ease of comprehension. Slightly over half the economists expected the peak to occur by the end of next year, down from the two-thirds holding that view in May. Looked at another way, about 54 percent expected the peak to occur in the 12 months beginning July 1, 1985. And, nearly 80 percent expected the next recession to begin by mid-1986. One-quarter or more of economists in the trade/transport and commercial banking groups expected the expansion to continue beyond mid-1986; on the other hand, academic/government economists were most pessimistic, with nearly 40 percent seeing an end by mid-1985. But the consensus was maintained that the expansion is likely to be shorter than the postwar average of 46 months.

TABLE 5. Expected Year for Peak of Current Business Cycle by Primary Affiliation of Business Economists, September 1984 (Percentage Distribution)

Half-Year Period	Primary Affiliation Group						
	Manufacturing etc.	Trade Transport etc.	Nonbank Financial	Commercial Banking	Academic and Government	Consulting and "Other"	All Groups
2nd Half 1984	11.5	11.4	9.5	3.1	11.1	2.9	8.3
1st Half 1985	13.5	20.0	9.5	12.5	27.8	23.5	17.2
2nd Half 1985	28.8	25.7	19.0	25.0	16.7	35.3	26.6
1st Half 1986	28.8	14.3	38.1	34.4	33.3	20.6	27.1
2nd Half 1986	11.5	20.0	14.3	25.0	5.6	14.7	15.6
1987 or Later	5.8	8.6	9.5	0.0	5.6	2.9	5.2

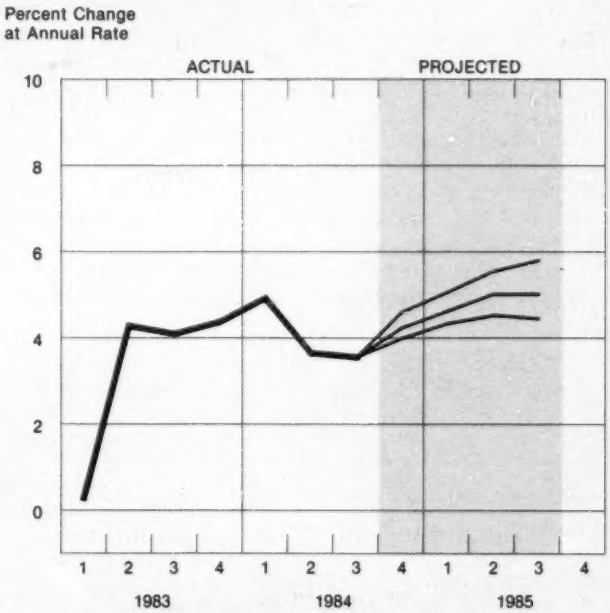
The question was "In what year and quarter do you expect the current business cycle expansion to peak?"

As in the May survey, the economists who were part of this consensus (that is, those who expected a peak before 2nd half 1986) were asked to give up to three reasons for expecting the current expansion to be shorter than the post-war average. The first reason given was overwhelmingly "high interest rates," as it was in May, with more than 79 percent giving that response, and no less than 65 percent of respondents in each affiliation group agreeing. Second responses were almost as concentrated (again just as in May), with about 71 percent specifying "large federal budget deficits," including more than half of each affiliation group. Given this concentration of responses for first and second reasons, it might be expected that the third reason given for a shorter-than-average expansion was more scattered among the several possibilities. Somewhat more than a third of all those giving a third reason specified "a continuing loss of competitiveness by U.S. industries in world markets." Another third reason mentioned by more than 10 respondents was "international default by one or more major debtor countries."

The business economists were asked one question relating directly to the political choice facing all of us in November: "Given the stated economic policies of the major party candidates for president, which one do you think has the best plan for solving our economic problems?" Since our respondents are *business* economists, it is probably not surprising that Reagan, not Mondale, was the choice of the substantial majority, by 64 to 9 percent. Still, 27 percent said neither had the best plan. Among the affiliation groups, only the academic/government economists were significantly different: they split equally between Mondale and Reagan, but the largest fraction (nearly half) opted for the "neither" choice.

Finally, the NABE members were asked to choose the type of investment expected to yield the highest return over the next 12 months. The most popular choice was treasury bills (35 percent), followed by stocks and bonds (24 percent each), real estate (8 percent) and "other" (7 percent). Gold trailed badly, with only 2 percent favoring the perhaps not-so-precious metal.

CONSUMER PRICE INDEX



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The Changing American Family: Childbearing, In and Out of Marriage

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FERTILITY

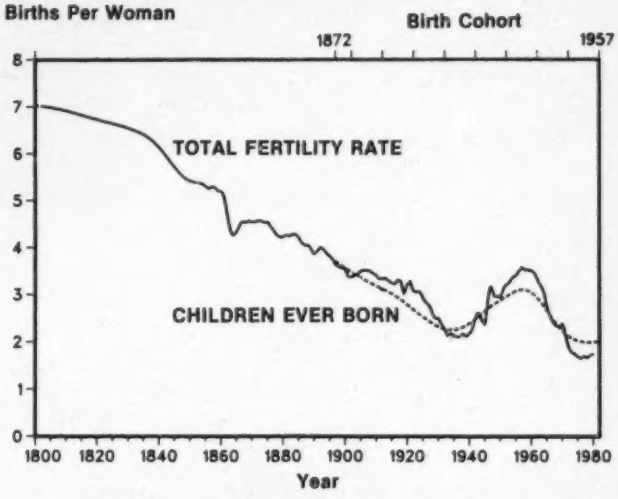
American families were large and unplanned at the start of the 19th century. White women bore, on average, about seven children, although high mortality rates resulted in a smaller number of surviving children. As the country modernized and mortality levels dropped, women began to have fewer children. In fact, fertility has decreased steadily from 1800 until the present, with the exception of a major but relatively short-lived reversal during the post-World War II baby boom from about 1947 to 1964. The result is that women are now having about two children, and almost all women are using contraception to plan both the spacing and number of their children.

Family Size and Childspacing

Chart 1 presents a broad overview of American fertility from 1800 through 1982 for white women, using two measures: the average number of children born to (or expected by) particular birth cohorts of white women and the annual total fertility rate, which indicates the average number of children each woman would have if each were to live through her childbearing lifetime (ages 15-44) bearing children at the same rate as women of those ages actually did in a specific year. Looking first at the total fertility rate, we see that fertility dropped from a high of seven children per woman in 1800 to a low of about 2.1 children during the Depression of the 1930s. Then came the postwar baby boom, bringing a sharp rise to a peak total fertility rate for white women of 3.6 births per woman in 1957, followed by an equally sharp drop to 1.7 in 1975, where the rate for white women hovered through 1982—substantially below the level of the 1930s.

Fluctuations in fertility over the last half century reflect both shifts in average family size and variation in the timing of childbearing. The actual average completed family size of cohorts of white women increased from about 2.2 for those born around 1910 to about 3.2 for those born during the 1930s who had their children during the baby boom (Chart 1). Average family size will decline to about two children for white women born during the 1950s if they have the number of children they say they expect. Among black women, average completed family size has been consistently higher, increasing from about 2.5 children for women born around 1910 to approximately four for those born in the 1930s. Expected family size for black women born during the 1950s is just over two.

CHART 1. Average Number of Children Ever Born to (or expected by) Birth Cohorts and Annual Total Fertility Rate, White Women



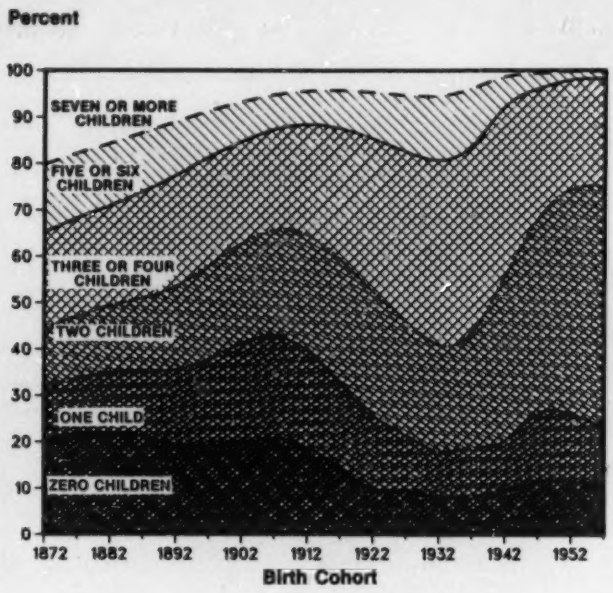
As fertility fluctuated over time, the distribution of family sizes changed markedly. Chart 2 shows that from the cohorts of the 1870s through those born around 1910, the decline in the number of children born per woman primarily resulted from a decrease in the proportion of large families and an increase in the share of small families. The percentage of white women with five or more children declined from 35 to 12 percent while the percentage with one to three children increased from about 35 to 60 percent. Meanwhile, the proportion with no children remained fairly steady at about 20 percent.

An important part of the larger average family size of the baby boom mothers, born in the 1930s, was the reduction in childlessness and one-child families; only 20 percent of them had one child or none, as compared to 42 percent among women born in 1910. The baby boom saw a large increase in the percentage of families with three or four children, but only a modest increase in families of five or six, and even less increase in very large families. The current reduction in family size, if the expectations of women born in the 1950s materialize, will result only marginally from an increase in childlessness, but rather will be due to a decrease in the percentage of families with more than two children and a substantial increase in two-child families.

The timing of childbearing also varied sharply across cohorts. Women born between 1910 and 1925 had their children at relatively older ages, as a result of postponing

Editor's Note: This is the second article excerpted from the authors' "The Changing American Family," *Population Bulletin*, Vol. 38, No. 4 (Population Reference Bureau, Inc.: Washington, D.C., 1983). It is published here with the kind permission of the Population Reference Bureau, Inc. The first article, concerning marriage and divorce, appeared in our Spring 1984 issue (11:3); a third will appear in 1985. Complete references for the material cited herein are contained in the *Population Bulletin* monograph.

CHART 2. Percentage Distribution of the Number of Children Ever Born to Cohorts of White Women



childbearing during the 1930s Depression and the wartime years of the early 1940s and catching up during the baby boom years. Women born during the 1930s did the opposite; they had their children early and rapidly during the late 1940s and 1950s and had relatively few children during the late 1960s and 1970s, resulting in a young average age at childbearing. This shift partly reflects the change in age at marriage; women born in the 1930s married earlier in the postwar years than did women who reached adulthood during the depression and wartime years.

The overall trends in fertility have been remarkably uniform for all subgroups of the population. Thus, fertility differentials observed before the baby boom—larger families among blacks and among those with less schooling and those who marry young—appear to have persisted into the 1980s. One exception is Catholic women, whose relatively high fertility fell particularly rapidly after the baby boom and is nc close to that of non-Catholic women.

Delayed Childbearing and Childlessness

Whether the cohorts of the 1950s will have the average two children that they tell surveyors they expect is open to question. The proportion who say they expect to have no children is no higher than the percentage of childless women among the prolific cohorts of the 1930s, but their actual current levels of childlessness are close to those of women at the same ages born at the turn of the century. In 1982, 63 percent of women aged 20-24 and 37 percent of women aged 25-29 were still childless—similar to the figures for cohorts born around 1900 but very different from the 50 percent and 19 percent, respectively for the 1930s cohorts at these ages. Further, the annual probabilities of having a first birth declined rather steadily from 1960 to 1979, due both to the rising age at marriage and lower first birth rates within marriage.

White women have been delaying childbearing more than black women. Some scholars project that as many as 29 percent of white women born during the 1950s may remain childless, despite their plans to the contrary, either because they find that they are unable to have children or because the same reasons that caused them to postpone chilbearing lead them in the end to forego children. Thus, an important question is whether these cohorts are only delaying childbearing or will in fact end up with very small families and much childlessness.

If many of these now childless young women do have the children they expect, their average age at first birth will be relatively high by recent standards. Some of these women are beginning to worry that their delay could reduce their chances of a successful pregnancy. Recent studies show that the inability to have children does increase with age, but only modestly before age 35—from about 6 percent unable to bear children at ages 20-24 to 15 percent for women aged 30-34. After age 35, the unfavorable odds increase rapidly, from about 28 percent among women aged 35-39 to 63 percent for those aged 40-44. Many young women have delayed having children because they believe that time out for childrearing could jeopardize their career ambitions; there is little guidance on the optimal strategy for combining family and career for women who want both. Delayed childbearing also could affect the financial position of parents at retirement. Having children later in life could enable a couple to accumulate assets before they start their family, but the burden of college expenses close to parental retirement might deplete retirement savings. Delayed childbearing also could require difficult adjustments if the life style enjoyed while childless is not compatible with childrearing.

Projections of future levels of childlessness are complicated by current changes in birth control technology and attitudes, values, and norms concerning parenthood and childlessness. Modern contraception and legal abortion make it easier to implement a decision to remain childless, while social norms and values prescribing parenthood have weakened, making it easier to choose to remain childless. A 1962 study of mothers in the Detroit metropolitan area found that 84 percent believed that "almost all married couples who can ought to have children," but 18 years later, in 1980, only 43 percent of these same women agreed with this idea. Similar attitudes were expressed by their young adult children who were also interviewed in 1980. Also, although nearly all the mothers said in 1980 that they would like their children to become parents, only one in eight said they would be bothered a great deal if this did not materialize. That Americans no longer rule out childlessness is further documented by a 1976 national study in which six of ten adults had neutral views about "couples who decide to have no children at all." The same study also revealed a decline in positive orientations toward parenthood and an increase in negative orientations between 1957 and 1976. The age that people consider ideal to have their first child has also gone up—by about half a year, on average, between 1970 and 1975.

Although parenthood has become more optional, there is no evidence of an embracement of childlessness. Substantial portions of Americans continue to value parenthood, believe that childbearing should accompany marriage, and feel social pressure to have children. Only a very small percentage view childlessness as an advantage, regard the decision not to have children as positive, believe that the ideal family is one without children, or expect to be childless

by choice. Nevertheless, it is likely that changing values concerning parenthood, the weakening of social norms prescribing marriage and parenthood, a wider range of alternatives for women, the desire to postpone marriage and childbearing, and the availability of modern contraceptives and legal abortion will result in a higher proportion of Americans remaining childless.

The long-term shift from high to low fertility has important implications for society and for family relations. At the societal level, low fertility means both a smaller and an older population. The counterparts of these effects at the family level are fewer kin and a kinship network composed of older relatives. Parents have both fewer children to support and nourish during their childrearing years and fewer children to rely on to support them in old age. Declines in fertility also generally reduce the available number of grandchildren, nieces and nephews, aunts and uncles, and cousins. However, the reduction in numbers of kin through the long-term decline in fertility has been partially offset by reductions in mortality. Also, for the next few decades, the elderly will actually have more children and younger relatives available to help them than they do now, for these will be the parents of the baby boom families. But when the parents of today's small families reach retirement age they will have fewer available younger kin than any of the elderly before them.

Small families can mean that parents have more time and resources for activities other than childrearing. Mothers probably have more time to pursue education, enjoy leisure activities, or to work outside the home. With fewer children to support and frequently income from two earners, parents of small families should be able to provide their children more opportunities and advantages, including advanced education. However, fewer children can also mean less public support for child-oriented services.

Large swings in fertility have wide-spread social and economic repercussions as well, particularly when the changes attain the dimensions of the baby boom. As the baby boom cohort matured, the United States incurred massive expenditures for new public schools and then expanded higher education facilities, and has had difficulty accomodating the large cohorts in the labor market. As smaller cohorts of children followed the baby boom generation, communities have abandoned schools no longer needed, while declining enrollments in the universities are anticipated. An important current debate centers on how the already ailing Social Security system can be stretched to cover the baby boom generation when it reaches retirement age and funds must come from the following smaller cohorts in the working ages.

Birth Control

The steady decline in fertility from 1800 to 1940 reflects the growing acceptability and use of birth control by American married couples even long before the advent of today's sophisticated contraceptive methods and legal abortion. Sketchy information suggests that at least 40 percent of women born in the 1840s and 60 percent of women born in the 1870s practiced some sort of birth control. Contraceptive use certainly was wide-spread by the early 20th century. Over 70 percent of women born in the first decade of this century reported using contraception, and many used more than one method. Most common were condoms, the contraceptive douche, and withdrawal; also important were rhythm, the diaphragm, and jelly or cream. These methods were effective enough to bring the birth rate to the low level of the 1930s when these women were in their prime childbearing years.

However, the "modern" contraceptive era began only during the 1960s when many American couples shifted from traditional methods to sterlization, the oral contraceptive pill, and the intrauterine device (IUD). Acceptance of the pill, first introduced in 1960, was rapid and wide-spread. Nearly one-fourth of all contracepting couples were using the pill by 1965 and 36 percent by 1973. Pill usage then dropped to about 33 percent in 1976 (the last year for which information is available)—probably due to concern about side effects. Less popular was the IUD, although 10 percent of contracepting married couples were using it by the mid-1970s.

Sterlization has become an important contraceptive method in the past two decades, particularly among older couples who have completed their families. Among all contracepting couples, the proportion reporting a contraceptive sterilization was still only 12 percent in 1965 but more than doubled to 27 percent by 1976. By that year, 40 percent of contracepting couples with the wife aged 30-44 had adopted this non-reversible method, with the operations divided nearly equally between husbands and wives.

Since its legalization nationwide by the Supreme Court in 1973, abortion has become an especially important and common form of fertility control in the United States. From close to 900,000 in 1974, the year after the Supreme Court ruling, legal abortions mounted rapidly to 1.55 million performed in 1980, although the annual increase slowed to just 1 percent between 1979 and 1980. Nearly 3 percent of all women of childbearing age had an abortion in 1980, representing about three abortions for every seven births; about one-third of these 1980 abortions were at least second abortions for the women concerned.

Although still not "perfect", modern birth control has helped reduce the incidence of unplanned and unwanted fertility, which was still considerable in the 1950s despite the widespread availability and usage of contraceptives. This in itself probably accounts for much of the overall fertility decline after 1960. Beyond that, the availability of highly effective contraceptive methods and legal abortion has probably altered orientations toward childbearing. Traditional contraceptive methods were effective in reducing overall fertility, but their substantial failure rates made it difficult for couples to plan confidently the timing and number of their children. For most women, motherhood has now become a matter of choice so that couples can rationally integrate their childbearing decisions with education and career plans, which makes possible the fuller and more effective participation of women in the labor market. As women work outside the home and gain satisfaction from it, the competing demands of children may seem costlier. Thus, the contraceptive revolution and legal abortion have probably helped reduce desired family size as well as unplanned childbearing.

SEXUAL ACTIVITY AND CHILDBEARING AMONG THE UNMARRIED

Increased sexual activity and childbearing among the unmarried have had important repercussions on both families and American society. Childbearing among unmarried women is the other reason, along with marital separation, for the growth in families headed by women on their own. It has also sparked controversy about the legitimacy of public

programs to help sexually active teenagers avoid unwanted pregnancies. Of course, premarital sexual activity and out-of-wedlock childbearing are not new in this country, as shown by limited historical data, but both are now much more prevalent and thus of growing social concern.

Sexual Activity Among Unmarried Teenagers

As Table 1 documents, premarital sexual activity among teenagers was already widespread in 1971 and increased steadily during the 1970s. Among never-married women aged 15-19 interviewed in metropolitan areas, 28 percent of the total and 46 percent of the 19-year-olds reported in 1971 that they had had sexual intercourse. By 1979, the figures were 46 percent for the 15-19-year-old never-married women as a group, 69 percent for the 19-year-olds, and 78 percent for never-married men aged 19. Most of this rise was accounted for by increased premarital sexual activity among white teenagers, although in 1979 the proportion of black never-married teenage women reporting that they had had sexual intercourse (65 percent) was still much higher than the 42 percent reported by their white counterparts.

Attitudes toward premarital sex also have become less restrictive over the last decade. The proportion of American adults agreeing that it is "always" or "almost always" wrong for a man and woman to have sexual relations before marriage dropped from 49 to 38 percent between 1972 and 1982. At the same time, however, the proportion who feel that extramarital sex—"a married person having sex with someone other than their spouse"—is always or almost always wrong remained consistently high at around 85 percent.

Contraception

From 1976 to 1979, the proportion of premaritally sexually active teenage women who said they had always used contraception rose from 29 to 34 percent, while those saying that they had never used contraception dropped from 36 to 27 percent. Teenagers also reported more use of the most effective contraceptive methods—the pill and the IUD—between 1971 and 1976, although there was a return to less effective traditional methods, especially withdrawal, by 1979.

Despite this increase in contraceptive use during the 1970s, a large proportion of sexually active teenagers remains unprotected, particularly at first intercourse, and practice tends to be careless and sporadic among those who do use contraception. The explanation does not seem to be a dearth of services, since government-supported clinics have provided services to teenagers in most areas in recent years. Nor do most unmarried teenage women fail to use contraception because they want a child; only one in five premaritally pregnant teenagers interviewed in 1979 said they had wanted to get pregnant. Apparently many are unrealistic about the risks of getting pregnant, while some are unwilling to admit to their degree of sexual involvement and prefer to view intercourse as an unexpected, irresistible occurrence rather than an anticipated event.

TABLE 1. Sexual Activity and Premarital Pregnancy and its Resolution among Metropolitan Area Women Aged 15-19: 1971, 1976, 1979 (Numbers in percent)

Characteristics	1971	1976	1979
Never-married women who ever had intercourse	28	39	46
All women who were ever pregnant before marriage	8	13	16
Premaritally pregnant women who married before resolution of pregnancy	33	23	16
Premaritally pregnant women who terminated pregnancy by abortion while still unmarried	23	32	37

Pregnancy

With the increase in sexual activity outstripping the increase in effective contraceptive practice, the proportion of all women aged 15-19 reporting that they had been premaritally pregnant doubled from 8 to 16 percent between 1971 and 1979 (Table 1). Again, this percentage in 1979 was higher for blacks (30 percent) than for whites (14 percent). However, premarital conceptions went up 141 percent for white adolescents in the 1970s, compared to an increase of only 19 percent among black teenagers.

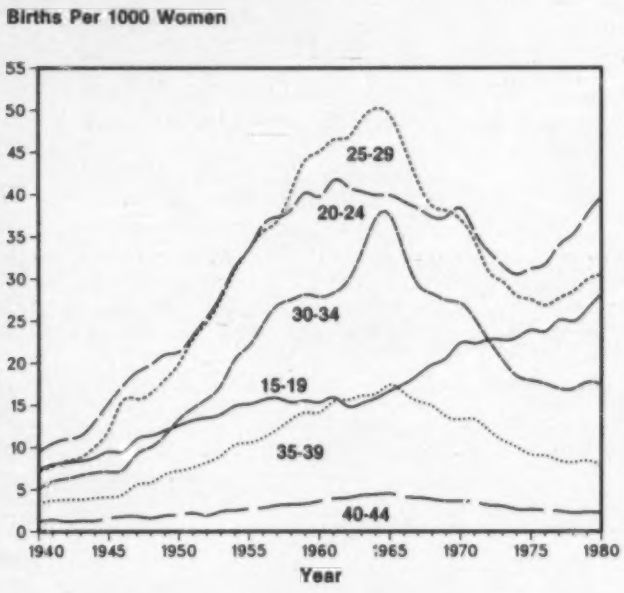
Teenagers have changed their responses to pregnancy. Nearly one-third of the premaritally pregnant teenagers interviewed in 1971 married before their expected delivery date; by 1979, the proportion had dropped to 16 percent. At the same time, among the premaritally pregnant who chose not to marry, the percentage who terminated the pregnancy by abortion increased from 23 to 37 percent (Table 1). Nationwide, the abortion rate for teenagers increased from 27 abortions per 1,000 women under age 20 in 1974 to 43 per 1,000 in 1980; 30 percent of all abortions in 1980 were obtained by teenagers. The abortion rate for all unmarried women also rose markedly over these six years, from 33 to 55 per 1,000, compared to an increase only from 9 to 11 per 1,000 for married women. By 1980, 79 percent of all abortions were obtained by unmarried women.

Out-of-Wedlock Childbearing

As Chart 3 shows, the birth rate for unmarried women aged 15-19 rose almost uninterruptedly from 1940 through 1980, due primarily to the rise in premarital pregnancies among adolescent women and their lesser inclination to legitimize births by marriage. In 1980, the birth rate for unmarried black teenageers was still nearly six times the rate for whites, but out-of-wedlock childbearing actually declined slightly among black teenagers during the 1970s, while the rate for white teenagers went up nearly 50 percent.

In contrast to the trend in out-of-wedlock childbearing, the birth rate for the *total* group of teenage women—the married plus the unmarried—has declined since the peak of the baby boom in the late 1950s. The reasons for these discrepant trends are that many fewer teenagers are married today, which lowers overall fertility, and the fertility of married teenagers has fallen in concert with the decline in the marital fertility of older women. In fact, the decline

CHART 3. Age Specific Birth Rates for Unmarried Women



in *overall* teenage fertility has been significant enough that the percentage of all children born to teenage women declined from 19 to 16 percent between 1974 and 1980.

Fertility rates also increased markedly for older unmarried women between 1940 and the early 1960s but then turned down, paralleling the trend in marital fertility (Chart 3). The downturn continued through 1980 for unmarried women aged 30 and over, but there was an increase in the late 1970s for women in their twenties. The share of all out-of-wedlock births occurring to women aged 20 and over rose from 47 to 59 percent between 1974 and 1980 because of the increase in fertility among unmarried women in their twenties, the rise in age at marriage, and the "aging" of the baby boom cohort into their twenties, which both increased the number of women in their twenties and decreased the number of teenagers. The birth rate for the total group of unmarried women has risen fairly steadily since 1940 because of the steady rise in the rate for teenagers, who are the preponderant group of unmarried women.

There is little to document the trend in sexual activity among older unmarried women, either those who have still never married or the separated, divorced, or widowed. Chart 3, however, shows that the chilbearing rates of unmarried women in their twenties exceed the rate for teenagers. Studies have shown that the fertility rate for previously married women is not insignificant, though well below that of continuously married women. In 1976, a substantial 54 percent of previously married women reported that they were using contraception or had been sterilized, and contraceptive use had risen more for these women than for currently married women between 1973 and 1976. It is also known that previously married women are more likely than never-married women to cohabit without marriage.

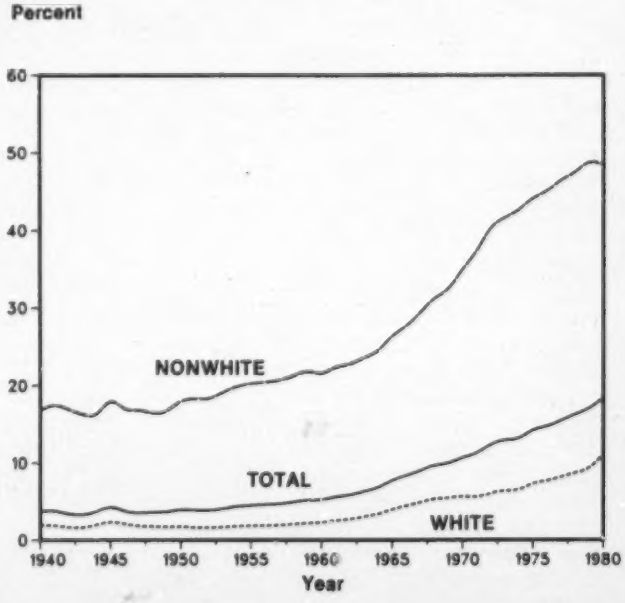
The increase in both the percentage of women who are unmarried and their rate of childbearing, coupled with the downturn in the fertility rate of married women, has sharply increased the percentage of all American births occurring out of wedlock in the past two decades (Chart 4). Between 1940 and 1960, the proportion of babies born to unmarried mothers fluctuated at 4 to 5 percent, but by 1980 the share had more than tripled to 18 percent. In 1980, out-of-wedlock births made up nearly half (48 percent) of total births to non-white women (of whom more than 90 percent are black), while the comparable figures for whites was 11 percent. Among teenage women in 1980, the proportion of out-of-wedlock births was 85 percent for blacks and 33 percent for whites.

The trend in nonmarital fertility among teenagers is especially troubling because many of the significant health risks and social and economic disadvantages associated with teenage childbearing are particularly serious for unmarried teenagers. Mortality risks are higher for both baby and mother when the mother is a teenager than they are when the mother is in her twenties. Though government-mandated programs now keep more pregnant teenagers in school, adolescent mothers still receive less education than other adolescents. This, along with child-care problems in often fatherless homes, can impede their search for and commitment to a job, which in turn increases the chances that they will find themselves on welfare. The difficulties often multiply because women who start childbearing in their teens tend to have more births subsequently than women who delay childbearing until their twenties.

Adoption

Adoption can provide children of unmarried mothers the advantages of a home with two better educated parents and a higher standard of living. Scarce data indicate that adoptions increased in the 1950s and 1960s but declined during the early 1970s, despite the continuing sizable number of children born out of wedlock and sharp increase in their proportion of all births. Apparently unmarried women now more often opt to raise their children on their own. This

CHART 4. Percentage of Children Born out of Wedlock



has reduced the number of children available for adoption—a shortage that could intensify if many of the women who are now delaying childbearing discover that they cannot bear a child and attempt to adopt. Recent cases of the use of "surrogate" mothers to bear a child for an adopting couple are a new response to this shortage. Though still rare, this practice is apparently growing and has raised concern in several states because of its ethical and legal ramifications.

Sexually Transmitted Disease

The incidence of sexually transmitted diseases has grown in recent years, reflecting largely the growth in numbers of unmarried adults and their increased sexual activity. Modern medicine and serious control efforts have successfully combatted some venereal diseases; the incidence of syphilis dropped to all-time lows in the late 1970s, although the early 1980s brought some signs of an upturn. Reported cases of gonorrhea, however, rose dramatically during the 1960s and early 1970s; and, although the number then leveled off and even declined somewhat, the 1980 rate was still three times the rate in 1960. Other such diseases, such as genital herpes, also appear to have increased rapidly during the 1970s. Certainly, sexually transmitted diseases continue to be a serious health problem and affect the way Americans approach the formation of relationships.

Public Policy

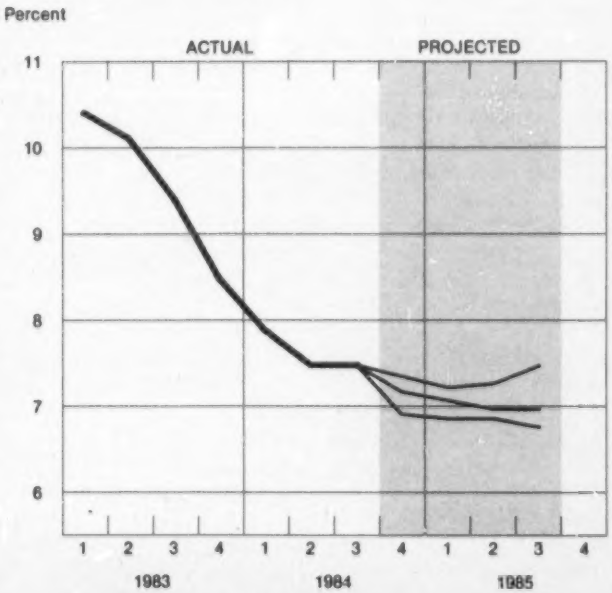
Considerable public controversy has centered on abortion and the provision of contracepive services to unmarried teenagers. Following court decisions of the the 1960s and early 1970s that lifted historical restrictions on abortion and the dissemination of contraceptives, the federal government has provided support for freely available contraceptive services. Several groups view provision of these services to teenagers as government intrusion on the rights of parents to supervise the behavior of their minor children. For them, the solution for adolescent pregnancy lies in familial control and parental guidance to restrict teenagers' sexual activity, which, they feel, is encouraged by freely available contraceptive services. Others doubt that adolescent sexual activity can be substantially decreased, despite parental efforts, particularly given growing sexual activity and cohabitation among older unmarried people. In their view, restricting contraceptive services for teenagers would increase teenage childbearing with all its negative implications.

Sex education in public schools provokes similar arguments. Some groups feel that sex education in schools encourages sexual activity and is best left to parents. However, more than two out of three Americans support sex education in schools, and some of them, noting young people's lack of sexual knowledge, argue that additional information would allow adolescents to deal more wisely with their sexuality. One recent study suggests that sex education in public schools does not lead to more sexual experience.

Public issues regarding abortion are not limited to adolescents. The right of all women to obtain an abortion, established by the 1973 Supreme Court decision, has been under attack by groups who champion the rights of the unborn. Supporters of the 1973 decision contend that the ability to control fertility is a fundamental right for every woman and that the elimination of the abortion option would result in more unwanted births and more recourse to illegal and potentially dangerous abortion, especially among unmarried teenagers.

The complexity of the abortion issue is reflected in the attitudes of individual Americans. In 1982, the overwhelming majority approved of legal abortion if the woman's health is seriously endangered by the pregnancy (92 percent), if she became pregnant as a result of rape (87 percent), or if there is a strong chance of serious defect in the baby (84 percent). But only about half approved of abortion if the family has a very low income and cannot afford more children, if the woman is unmarried and does not want to marry the man, or if she is married and wants no more children. Just over 40 percent of Americans approve of all six of these reasons for abortion, while only some 7 percent disapprove of all six—a substantial change from 1965 when only 11 perent aproved of all six reasons and 22 percent disapproved all six. The increase in approval, however, occurred primarily between 1965 and 1973, and there has been little change since then.

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

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Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1983:1	1983:2	1983:3	1983:4	1984:1	1984:2	1984:3	1984:3	1984:4	1985:1	1985:2	1985:3	1983	1984	1985
GROSS NATIONAL PRODUCT	3,174	3,267	3,347	3,432	3,553	3,645	3,695	3,723	3,796	3,872	3,945	4,021	3,305	3,680	3,981
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	212.9	214.3	215.9	218.2	220.6	222.4	224.4	224.4	226.6	229.3	232.0	235.0	215.3	223.5	233.6
CORPORATE PROFITS AFTER TAXES	102.6	123.4	142.6	141.1	150.6	150.2	139.3	157.0	160.0	162.0	164.1	166.5	127.4	155.0	165.0
UNEMPLOYMENT RATE (percent)	10.37	10.10	9.40	8.47	7.87	7.47	7.47	7.30	7.00	6.90	6.80	6.80	9.58	7.40	6.80
INDUSTRIAL PRODUCTION (index, 1967 = 100)	138.5	144.5	151.8	155.5	159.8	163.1	165.7	166.0	168.0	169.3	171.0	172.0	147.6	164.0	172.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.643	1.690	1.782	1.699	1.968	1.895	1.662	1.750	1.700	1.650	1.600	1.600	1.704	1.820	1.630
CONSUMER PRICE INDEX (% change from prior quarter or year)	0.3	4.3	4.2	4.4	5.0	3.7	3.6	3.7	4.4	4.8	5.2	5.2	3.2	4.3	4.7
3-MONTH TREASURY BILL RATE (%)	8.08	8.42	9.19	8.79	9.13	9.84	10.34	10.30	10.40	10.50	10.80	10.80	8.62	9.90	10.90
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	11.99	11.57	12.68	12.76	12.94	14.18	13.62	13.85	13.90	13.90	14.00	14.05	12.25	13.70	13.98
GNP IN 1972 DOLLARS	1,491	1,525	1,550	1,573	1,611	1,639	1,647	1,660	1,675	1,687	1,701	1,712	1,535	1,647	1,704
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	982	1,006	1,016	1,032	1,044	1,064	1,066	1,074	1,085	1,093	1,102	1,109	1,009	1,066	1,106
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	161.6	165.3	172.6	184.5	193.3	202.9	210.5	210.0	216.0	220.0	223.0	226.0	171.0	206.0	224.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	46.2	53.4	57.2	57.8	60.6	60.8	60.1	61.0	59.0	58.0	58.0	58.0	53.7	60.3	57.5
CHANGE IN BUSINESS INVENTORIES (1972 $)	−16.5	−6.1	0.9	7.2	31.6	20.3	30.0	18.0	18.0	17.0	17.0	15.7	−3.6	22.0	15.5
NET EXPORTS (1972 $)	22.9	13.6	11.9	2.0	−8.3	−11.4	−26.6	−11.0	−12.0	−12.0	−12.0	−10.0	12.6	−10.0	−11.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	119.0	117.2	115.6	113.0	112.2	123.2	125.4	126.0	127.0	129.0	130.0	132.0	116.2	122.0	133.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	175.3	175.2	176.4	175.8	177.3	178.9	181.4	180.0	181.0	182.0	183.0	184.0	175.7	179.0	184.0

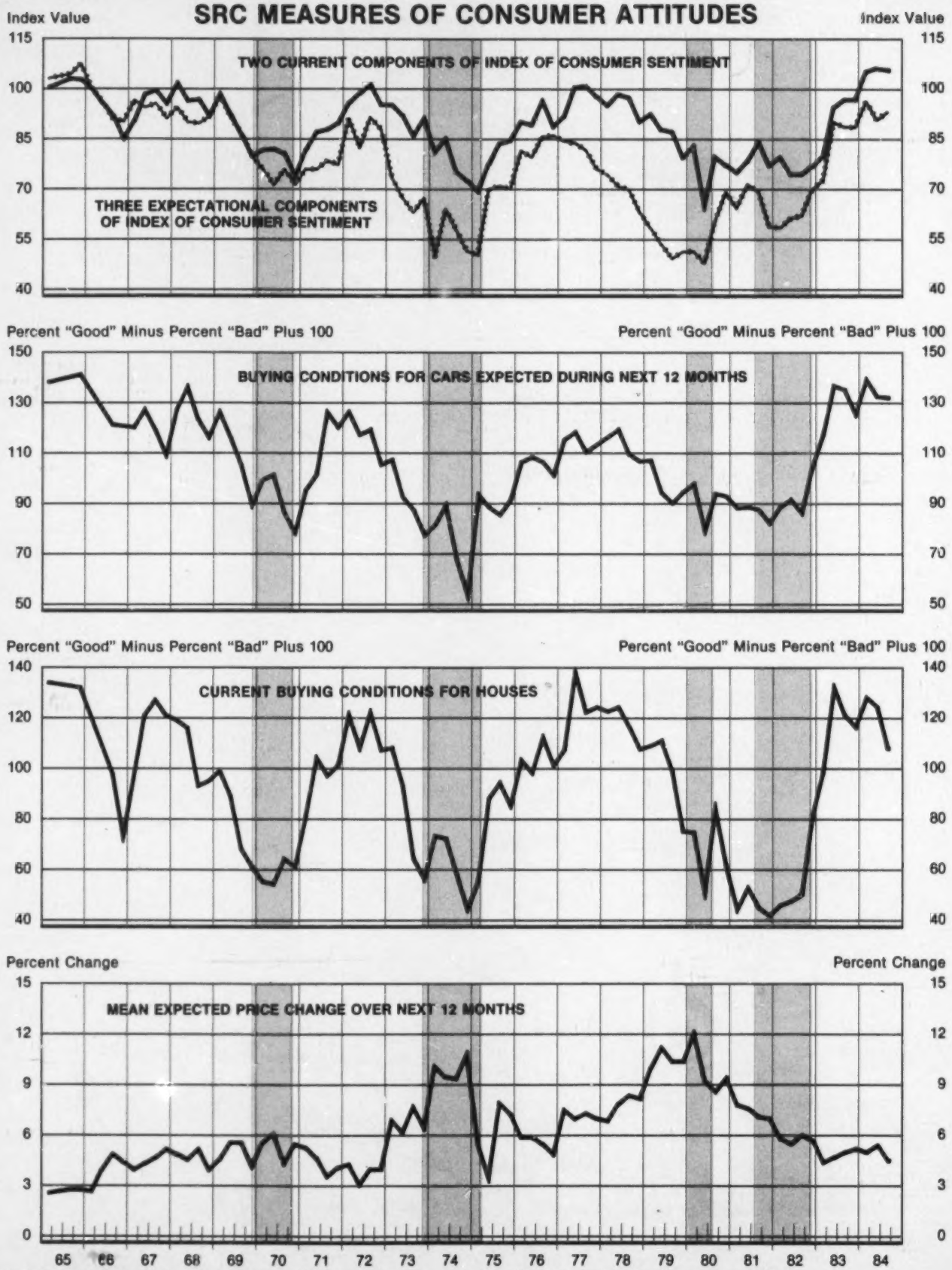
SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1984:1	1984:2	1984:3	1981	1982	1983
GROSS NATIONAL PRODUCT	3,028	3,026	3,061	3,080	3,110	3,174	3,267	3,347	3,432	3,553	3,645	3,695	2,958	3,069	3,305
PERSONAL CONSUMPTION EXPENDITURES	1,892	1,931	1,961	2,001	2,046	2,070	2,142	2,181	2,230	2,277	2,333	2,361	1,849	1,985	2,156
GROSS PRIVATE DOMESTIC INVESTMENT	481.7	436.2	431.2	415.9	376.2	405.0	449.6	491.9	540.0	623.8	627.0	662.3	484.2	414.9	471.6
NET EXPORTS	31.7	27.7	35.5	6.6	6.3	19.6	−6.5	−16.4	−29.8	−51.5	−58.7	−89.9	28.0	19.0	−8.3
GOVERNMENT PURCHASES	622.7	630.9	633.7	656.3	681.0	678.8	682.2	689.8	691.4	704.4	743.7	762.0	596.5	650.5	685.5
DISPOSABLE PERSONAL INCOME	2,110	2,132	2,157	2,196	2,238	2,261	2,303	2,367	2,429	2,502	2,554	2,606	2,042	2,181	2,340
PERSONAL SAVING RATE (% of disposable income)	7.6	6.7	6.3	6.1	5.8	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.7	6.2	5.0

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late November, and projected data, released by ASA-NBER in September, are displayed for third quarter 1984.

Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

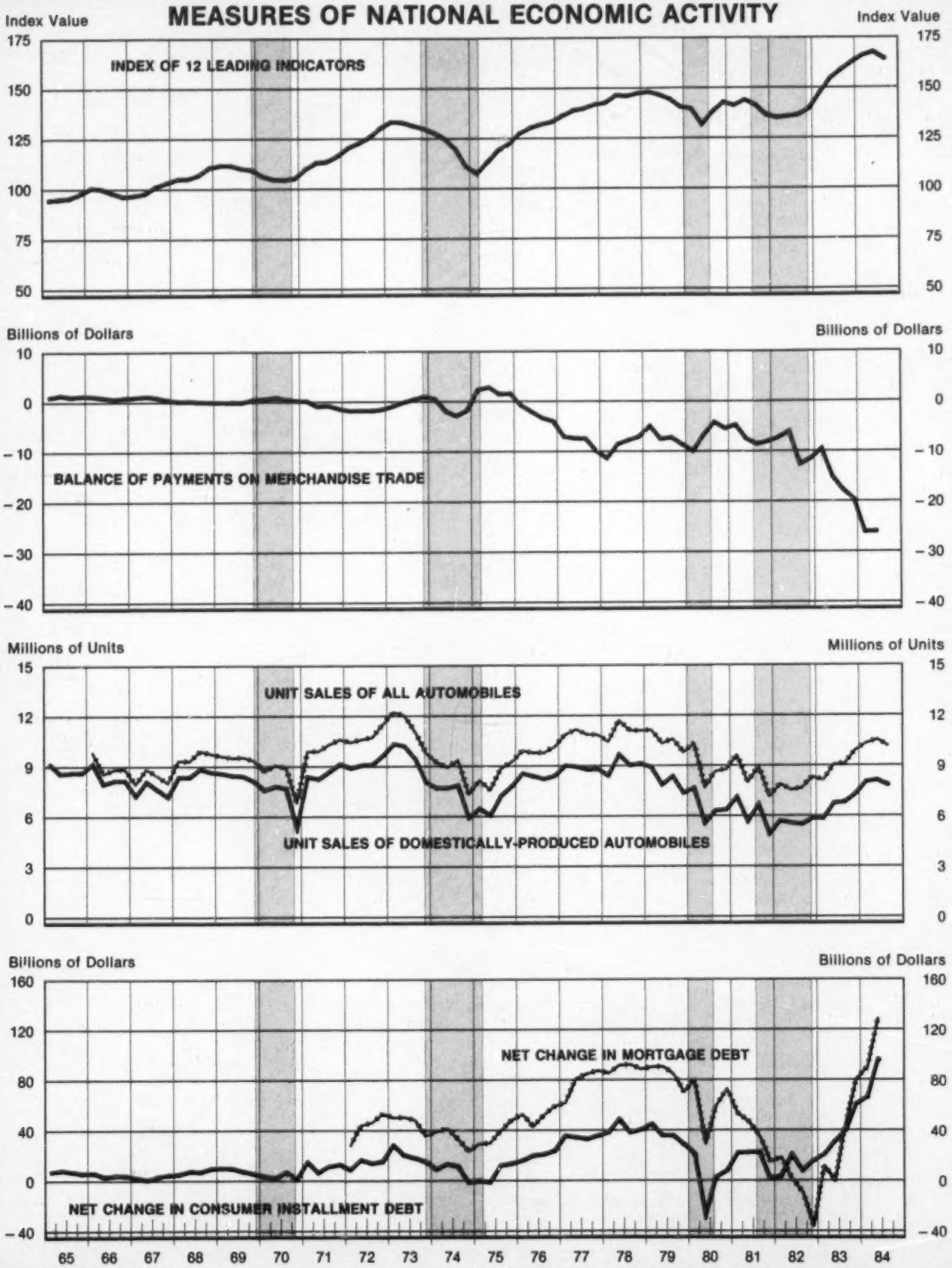
*Substantial revision of the data for variables marked with an asterisk has occurred since the last printing.

SRC MEASURES OF CONSUMER ATTITUDES



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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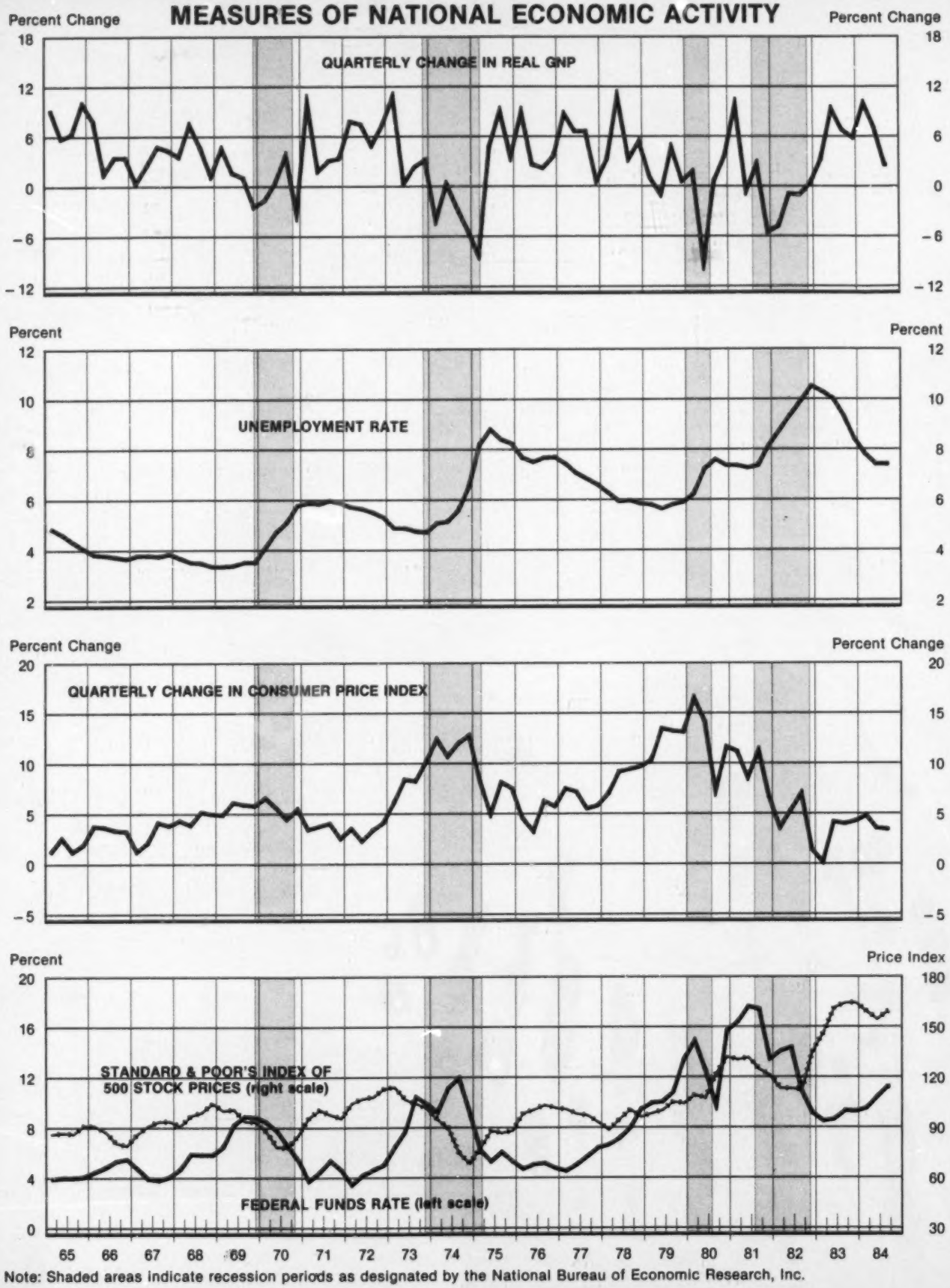
MEASURES OF NATIONAL ECONOMIC ACTIVITY



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The Impact of Work Schedules on the Family

by Graham L. Staines and Joseph H. Pleck
with a foreword by Urie Bronfenbrenner

This new volume presents the findings from the first systematic study of the effects of work schedules on family stress. Authors Graham L. Staines and Joseph H. Pleck investigate the nature and characteristics of contemporary patterns of work schedules for married couples (with and without children) and for single-parent families and describe the effects of these work patterns on family life.

This study is the first to give specific attention to the way husbands' and wives' work schedules interact and influence family life for each of them. The volume offers new knowledge about the psychological effects of some of the major changes taking place in American society, including the influx of women into the paid work force and the concomitant rise in the number of dual-earner couples. It offers critical insight into what may be one of the most salient social issues of the future.

The authors look at the relationship of people's work schedules to the amount of time spent in specific family roles (taking care of children or doing housework, for example), perceptions of interference between work and family roles, and levels of family adjustment and conflict.

The findings are based on the survey responses from a large national sample (2,850 American households) and reflect the actual distribution of different types of work schedules among the population.

This innovative research includes a close examination of four aspects of the work schedule: patterns of days worked each week, patterns of hours worked each day, number of hours worked each week, and schedule flexibility. It gives careful attention to both the separate and combined effects of these variables on specific aspects of family life.

The authors reach important conclusions about many areas within the domains of work and family, particularly about the critical relationships between people's sense of flexibility and control over their own work schedules and the resulting levels of stress or satisfaction within their families.

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ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

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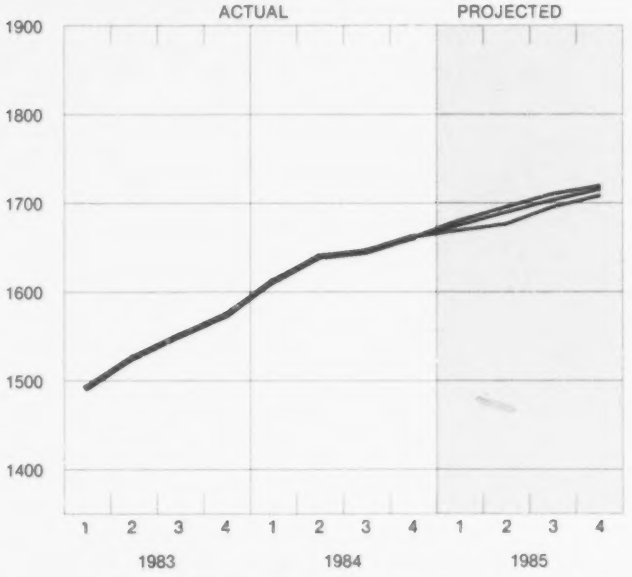
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

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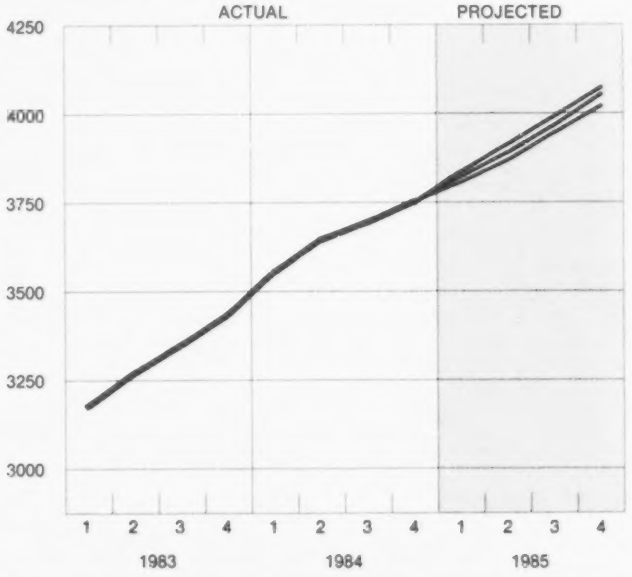

Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

The U.S. Economic Outlook for 1985-86

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Review of the Forecast for 1984

A year ago at the Economic Outlook Conference we predicted that real GNP would grow by 6.5 percent for calendar 1984. For the second successive year, the RSQE forecast was among the most optimistic then on record. The data currently available for the first three quarters of this year and our present forecast for the fourth quarter indicate that real GNP will actually increase by nearly 6.9 percent—a bit more than we had predicted. In terms of 1972 prices this translates into an increase of $105 billion compared to our forecast of $99.3 billion made one year ago. Our forecast of real GNP for 1984 now appears to have been in error by only about one-third of one percent.

We underestimated the change in real personal consumption expenditures and gross private domestic investment by about $13 billion in each case. The predicted change in real government purchases of goods and services was just about right. The major offsetting forecast error occured in net exports. We expected real net exports to fall from a 1983 level of some $12 billion to about zero in 1984. We now anticipate a real net export deficit of about $17 billion for the current year. Almost all of this error was due to our inability to anticipate correctly the rapid increase in real imports as the value of the U.S. dollar climbed by 10 percent from the third quarter of 1983 to the third quarter of 1984.

The rates of wage and price inflation experienced in 1984 were somewhat less than we had expected. We had forecast that wages and prices would increase more rapidly in 1984 than they had in 1983; but, with the exception of the measure given by the consumer price index, inflation rates have actually fallen this year. The personal comsumption deflator, for example, increased at a 3.7 percent rate for 1983. We predicted a 4.6 percent rate for 1984, and the actual rate appears to be 3.3 percent.

We correctly anticipated the sign but not the magnitude of the change in the unemployment rate for 1984. We forecast that the unemployment rate would decline from a 1983 average of 9.6 percent to 8.3 percent this year; it actually fell to an average level of 7.6 percent for 1984.

Finally, we had expected a modest decrease in interest rates, not the actual increase that took place.

The Current Expansion in Historical Perspective

As of the third quarter of 1984, the economy had been expanding for eight straight quarters. A comparison of the current expansion with some of its predecessors provides some useful insights into the strengths, weaknesses, and peculiarities of the current situation. Table 1 contains comparative statistics which can be used for this purpose. In each case, calculations are based on the first eight quarters following the trough quarter of real GNP.

It is clear from this table that there are many similarities with previous expansions. The eight-quarter increases in real GNP, final sales, personal consumption expenditures, and government purchases of goods and services show a great deal of uniformity with previous expansions. Two outstanding differences from previous expansions are found in residential construction and imports, both of which are running well ahead of historical norms. As already noted, the increase in imports has outpaced the growth in exports, leading to a substantial deficit in the real trade balance. Real interest rates remain at historical highs as well. The increase in real interest rates during this expansion is due to an increase in nominal rates coupled with a decrease in the rate of inflation.

It is at least somewhat surprising that business fixed investment has risen so strongly in the face of such high real interest rates. Consider, however, the following combination of factors which may help to explain this apparent inconsistency:

- strong growth in final demand even in the face of a deteriorating net export balance,
- new tax depreciation guidelines especially favorable to cash-flow,
- a prevalence of old and outmoded capital in many industries now faced with stiff international competition, and
- the advent of new computer-based technologies which hold the promise of providing substantial improvements in industrial productivity.

Note, in addition, that the increase in unit labor costs has been distinctly modest in the current expansion. In the two years since the trough of the 1981-82 recession, unit labor costs have risen by only 2.3 percent—compared with 8 percent in the first two years of the 1975-80 expansion and almost 13 percent for 1971-73. With a constant state of technology, one would expect that the combination of favorable wage costs and high real interest rates would encourage a substitution toward labor and away from capital in the structure of production. In the present circumstance of rapidly changing technologies and a quest to modernize America's smoke-stack industries, favorable wage costs may well be making a major contribution by enabling industry to afford investment in new capital in the presence of high real interest rates.

A final feature of the current expansion which requires noting is the magnitude of the federal deficit. In the third quarter of 1982, the deficit was 5.3 percent of GNP. After eight quarters of economic expansion, it has come down only to 4.7 percent of GNP. The current expansion began with the deficit unprecedentedly high for a peacetime period, and the deficit has fallen barely at all despite the vigor of in-

Editor's Note: This is an abridged version of Dr. Hymans' presentation to the 32nd annual Conference on the Economic Outlook at The University of Michigan, November 1984. Shortly before the conference took place, Dr. Hymans was awarded the Theodore H. Silbert Award for Economic Forecasting, given annually to recognize "accuracy, timeliness, and professionalism in economic forecasting." Forecasts of real GNP growth, the unemployment rate, and the inflation rate for the period 1981-1983 were evaluated for the award, which is sponsored by the Sterling National Bank and Trust Company of New York City.

TABLE 1. Comparison of Recent Economic Expansions

Indicator	Expansions				
	1958-60	1961-69	1971-73	1975-80	1983-??
Initial Trough Quarter	1958:1	1961:1	1970:4	1975:1	1982:3
Duration of Expansion (Number of quarters)	8	35	12	20	–
Percent Changes During First 8 Quarters of Expansion					
Real GNP and Components:					
GNP	11.3	10.5	16.8	11.2	11.7
Final Sales	8.3	8.9	14.8	9.0	9.1
Consumption	9.0	8.6	13.9	11.5	10.4
Consumer Durables	13.3	22.0	38.4	25.7	27.0
Business Fixed Investment	9.6	10.1	27.6	11.4	26.2
Residential Construction	32.3	20.1	29.0	43.9	66.3
Exports	13.0	5.0	45.4	6.7	2.4
Imports	18.1	16.9	21.6	23.4	42.9
Government Purchases	2.3	9.0	2.2	0.4	5.3
Wages and Prices (Private Nonfarm Sector):					
Hourly Compensation	9.3	8.0	22.8	16.1	8.6
Unit Labor Cost	1.9	0.1	12.7	8.0	2.3
Price Index	4.0	2.9	12.5	10.8	6.8
M2Plus	NA	15.9	34.4	29.6	22.7
Trade-Weighted Exchange Rate Index	NA	NA	−18.6	10.8	18.3

Level at Initial Trough (T) and After First 8 Quarters of Expansion (T+8)

	T	T+8	T	T+8	T	T+8	T	T+8	T	T+8
Civilian Unemployment Rate (Percent)	6.3	5.2	6.8	5.8	5.8	4.8	8.2	7.5	10.0	7.5
Interest Rates:										
3-Mo. T-bills	1.8	3.9	2.4	2.9	5.4	7.5	5.8	4.6	9.3	10.3
(Real T-bill)[1]	0.6	1.8	1.9	1.4	0.4	2.2	− 7.2	−0.5	4.2	6.9
Aaa Corporate	3.6	4.6	4.3	4.2	7.9	7.7	8.7	8.0	13.8	13.0
(Real Aaa)[1]	2.4	2.4	3.9	2.7	2.9	2.3	− 4.3	2.9	8.6	9.5
Variables as % of GNP:[2]										
Corporate Profits[3]	7.9	10.3	8.5	10.1	6.8	7.9	6.0	8.1	5.3	7.7
Federal Deficit	1.7	− 1.5	0.8	0.3	2.0	0.3	3.1	2.0	5.3	4.7
Business Fixed Investment	9.2	9.1	8.8	8.8	10.2	11.1	10.0	10.0	11.1	12.5
Imports	4.0	4.2	4.0	4.2	6.2	6.4	6.0	6.6	8.1	10.5

[1]The real interest rate for a given quarter is defined as the corresponding nominal rate less the rate of inflation of the private nonfarm deflator during the four quarters ending with the given quarter.

[2]Profits and the federal deficit are both in current dollars as a percent of current dollar GNP. Investment and imports are in constant dollars as a percent of real GNP.

[3]Includes inventory valuation and capital consumption adjustments.

come growth in the past two years. This is clearly the mark of a federal budget dominated by a substantial *structural* deficit. There seem to be considerable disagreements as to whether or not the huge federal deficits implied by current tax laws and expenditure plans will produce permanently *rising* interest rates. There is little doubt, however, that the high deficit outlook is a major contributing factor to the comparatively *high level* of interest rates which has characterized the current expansion. In turn, these high interest rates have attracted financial capital from aboard, pushed up the international exchange value of the dollar, and encouraged the sharp deterioration in our net export account.

Inputs to the Forecast

The *federal tax* program contained in our Control Forecast includes the provisions of the Deficit Reduction Act of 1984. This legislation provides for tax increases of $8.6 billion for fiscal '85 and $17.7 billion for fiscal '86. About half of the increase is in personal taxes; much of the rest is in corporate profits taxes. An increase in the federal excise tax on liquor and a delay in the reduction of the telephone excise tax together represent about 15 percent of the tax increase in fiscal '86.

The Control Forecast also includes the inflation indexation of the personal income tax which is scheduled to begin

January 1, 1985. With indexation, the personal income tax brackets will be adjusted to remove the impact of inflation on effective tax rates under the progressive tax structure. In effect, taxpayers will move through the existing tax brackets on the basis of changes in their real incomes rather than their current dollar incomes. We estimate that indexing will reduce tax revenue by about $3 billion in fiscal '85 (when it is only in effect for three-fourths of the fiscal year) and by $14 billion in fiscal '86. Even with modest inflation the tax reduction from the indexing program will grow substantially. We estimate that in the final quarter of calendar 1986 indexing the personal income tax will cost the Treasury almost $24 billion at annual rate.

The *federal expenditure* assumptions in our forecast are summarized in Table 2. Current estimates indicate that expenditures for fiscal 1984 totalled $860 billion—up $44.4 billion from the previous year. We are assuming increases of about $70 billion for both fiscal '85 and fiscal '86. The larger increases in expenditures can be traced to three areas of the budget. The rapid decline in unemployment which occurred in fiscal 1984 is replaced by a much slower decline over the next two years. The result is a smaller reduction in unemployment benefits in fiscal '85 and fiscal '86 than was posted for fiscal '84. The totals for both nondefense purchases and federal subsidies in fiscal '84 were affected by the Payment-In-Kind (PIK) program, which provided surplus commodities to farmers who agreed to set aside productive land during the 1983 growing season. When these categories are purged of the effect of the PIK program, they both show a drop in expenditures from fiscal '83 to fiscal '84. We have assumed that both nondefense purchases and subsidies will instead show some increase for fiscal '85 and fiscal '86.

After growing by 10.3 percent in fiscal '84, defense spending is assumed to increase by 9¾ percent for each of the next two fiscal years. This represents about a 5 percent real increase in the procurement portion of the defense budget for each year.

TABLE 2. Federal Government Expenditures and Receipts (National Income and Product Accounts, billions of dollars)

Expenditures, Receipts, and Deficit	Fiscal 1984[1]	Fiscal 1985[2]	Fiscal 1986[2]
Total Expenditures	860.0	929.9	1001.6
Purchases of Goods and Services	284.5	320.0	349.0
National Defense	216.7	237.5	260.8
Nondefense	67.8	82.5	88.2
Transfer Payments	350.1	364.9	388.5
Unemployment Benefits	16.9	14.5	12.8
Grants-in-Aid to State and Local Governments	90.7	93.9	96.3
Net Interest Paid	110.3	133.4	149.8
Subsidies less Current Surplus of Gov't. Enterprises	24.4	17.8	18.0
Total Receipts	690.1[3]	754.6	828.0
Deficit (−)	−169.8	−175.3	−173.7

[1]Data for Fiscal 1984 are from the *Survey of Current Business*, October 1984.
[2]RSQE projections and forecasts for fiscal years 1984 and 1985.
[3]Receipts and Deficit for 1984:3 are RSQE Projections.

The Deficit Reduction Act of 1984 also provides for some expenditure cuts to help reduce the deficit. The largest component of this part of the legislation is a reduction in transfer payments of $3.2 billion in fiscal '85 and $1.8 billion in fiscal '86, consisting of a decrease in medicare benefits and a one-time shift in the payment of military retirement benefits, which saves the payment of one month's benefits in fiscal '85.

The net result of our budget assumptions and our Control Forecast is the federal deficit path shown in the bottom line of Table 2. The deficit figures show very little change over the three years, ranging from $170 to $175 billion. The Deficit Reduction Act is, as advertised, only a downpayment on the deficit. The next Congress will need to consider what steps must be taken—whether expenditure cuts, tax increases or both—to make further progress on the deficit.

In the presence of what has been very expansionary fiscal policy, the monetary authorities have had to assume all responsibility for keeping the expansion under control. As we noted earlier, this resulted in a policy which supported the rise in interest rates during the first eight months of this year as the economy grew at a robust annual rate of 8.6 percent during the first half of the year. With the slowing of economic activity in the third quarter, the pressure on interest rates has eased somewhat. Three-month treasury bill rates have fallen from a high of 10½ percent for the month of August to 9½ percent for the second half of October. We believe that with modest growth and low inflation continuing in the fourth quarter, *the Federal Reserve will continue to ease policy* through the winter, supporting a further reduction in interest rates. Specifically, we are assuming that

- the Fed will lower the discount rate from the current level of 9 percent to 8.5 percent early next year and hold it there through the end of 1986, and
- the monetary base will grow at an average rate of 5 percent per year over the next two years.

The further reduction in interest rates which we are forecasting to continue through most of 1986 will permit the governments of our major trading partners to position their interest rates higher relative to U.S. rates but lower than they have been in recent months. The relatively less attractive position of our interest rates and our deteriorating nominal trade balance are expected to imply a decline in the value of the dollar. We are anticipating that—on a trade-weighted basis—the *U.S. dollar will decline* in value by about 3½-4 percent during each of the next two years.

The expected depreciation of the dollar and the strengthening of the economies of our major trading partners should yield an *increasing volume of exports*. We are forecasting that real exports will grow at a 6 percent annual rate during the first half of 1985, a 6½ percent rate during the second half of 1985, and almost a 7½ percent rate during 1986.

Thus far the economic expansion has been characterized by modest inflation in most commodity prices and an evident *weakness in oil prices*. The recent decision by the members of OPEC to cut supply in order to shore up oil prices should be sufficient to prevent a sizeable drop in the price of oil. We have assumed that, after dropping by just under 2 percent in the current quarter, oil prices will stabilize and then begin to rise at a 2 percent annual rate in mid-1985, a 4 percent rate through early 1986, and a 5 percent rate through the rest of 1986.

Our other assumptions regarding price movements include:

- For the *prices in own currencies of goods and services which we import* (other than oil), we have assumed an inflation rate of 4½ percent in early 1985, 5 percent for the last three quarters of 1985, and 5½ percent during 1986.
- *Farm prices* are assumed to rise at a 6 percent annual rate through the end of 1986.
- *Natural gas prices* are assumed to rise by 5½ percent during 1985 and by 7 percent during 1986.

Overview of the Control Forecast

The major features of our Control Forecast are summarized, on a calendar year basis, in Chart 1. We are now estimating that total national production—real GNP—for 1984 will be up by 6.9 percent over the 1983 level. That pace of growth is not expected to continue, and we are forecasting that real GNP will be up by 3.8 percent for 1985 and by 4.8 percent for 1986. As will be seen in our discussion of the dynamics of the forecast, some care is required in coming to a proper understanding of the higher growth rate being forecast for 1986 versus 1985. Specifically, we are *not* forecasting that the economy's growth rate will accelerate from now through the end of 1986, and such a pattern should not be read into the calendar-year growth rates shown in Chart 1. It is, however, proper to infer that our Control Forecast implies a continuation of the current expansion through both 1985 and 1986.

CHART 1. Overview of RSQE Forecast for 1985-86

*Includes inventory valuation and capital consumption adjustments.

Accompanying this persistence of economic expansion is a continuation of the most recent pattern of annual reductions in the rate of unemployment. For 1985 we expect a small reduction in unemployment to an average level of 7.2 percent for the year, and that is followed by a somewhat larger decline to a 6.6 percent average for 1986.

With growth continuing and the labor market strengthening, we anticipate that the rate of inflation will be edging up over the next two years. As measured by the personal consumption deflator, consumer prices are forecast to be 4.4 percent higher in 1985 than in 1984, and another 5.3 percent higher in 1986. As noted, the tightening of markets is one important reason for the rising rate of inflation during the next two years. Another is the international depreciation of the dollar, which is also a part of our Control Forecast. Thus, with the dollar having strengthened during this year, the average price level—in dollars—for our imports of goods and services is estimated to have declined by about one percent for 1984. In contrast, with the dollar dropping in value during 1985 and 1986, we estimate that import price inflation will average 5 percent for 1985 and 10 percent for 1986. These swings of roughly 5-6 percent annual increases in import inflation account for nearly one-half of one percentage point per year in the acceleration of the rate of inflation in consumer prices. If we were to back these out of the inflation forecast shown in Chart 1, we would have the price level up by about 4 percent for 1985 and less than 4½ percent for 1986. Thus, we are not forecasting any really substantial renewal of industrial inflationary pressures—sometimes called core inflation—during the next two years. But we will have to pay a penalty in higher prices as the overvalued dollar starts to move down.

As is seen in the fourth panel of Chart 1, we are forecasting that short-term interest rates will average nearly 100 basis points less in 1985 than in 1984, but will then move up slightly in 1986.

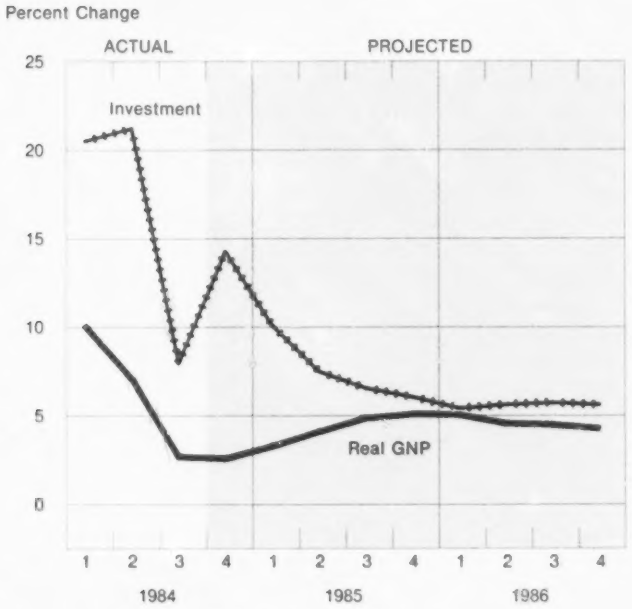
With respect to incomes, we are forecasting sizeable gains for the next two years. Consumer purchasing power—real disposable income—is forecast to be up by almost 3½ percent in 1985 and about 3¾ percent the following year. Corporate profits (including inventory valuation and capital consumption adjustments) should remain at about 7¾ percent of GNP—well above the postwar low of 5.2 percent reached in 1982.

The Dynamics of the Control Forecast

Proper interpretation of the Control Forecast requires an understanding of the dynamics underlying the annual changes and averages shown in Chart 1. The quarterly paths being forecast for a number of key macroeconomic variables are shown in Charts 2-6. Additional quarterly detail is contained in Table 3.

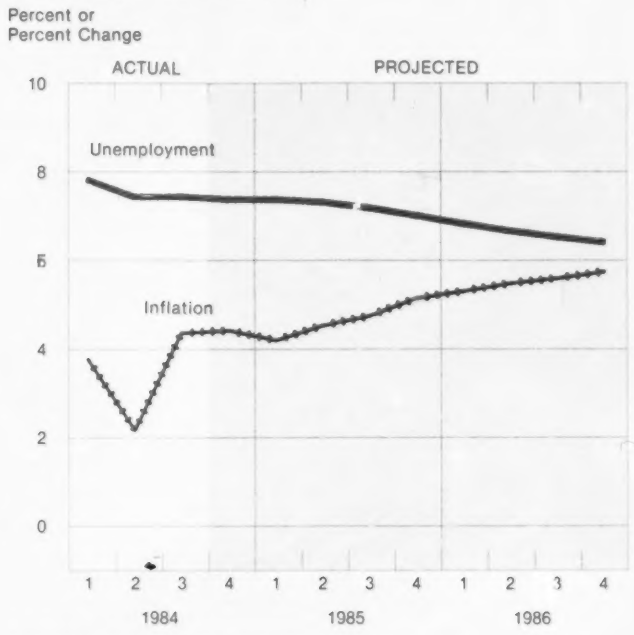
The forecast pattern for real GNP growth is shown in Chart 2. The 2.7 percent growth rate estimated for 1984:3 is forecast to be followed by a 2.6 percent annual rate of growth in the current quarter and 3.3 percent in the first quarter of 1985. The growth rate accelerates during the balance of 1985 and peaks at 5.1 percent in the closing quarter of next year. Thereafter, the growth rate decelerates

CHART 2. Annual Rates of Growth of Real Gross National Product and Business Fixed Investment (1972 dollars)



Sources: Actual data, U.S. Department of Commerce; projected data RSQE Forecast.

CHART 3. Unemployment Rate and Annualized Inflation Rate (Personal Consumption Deflator)



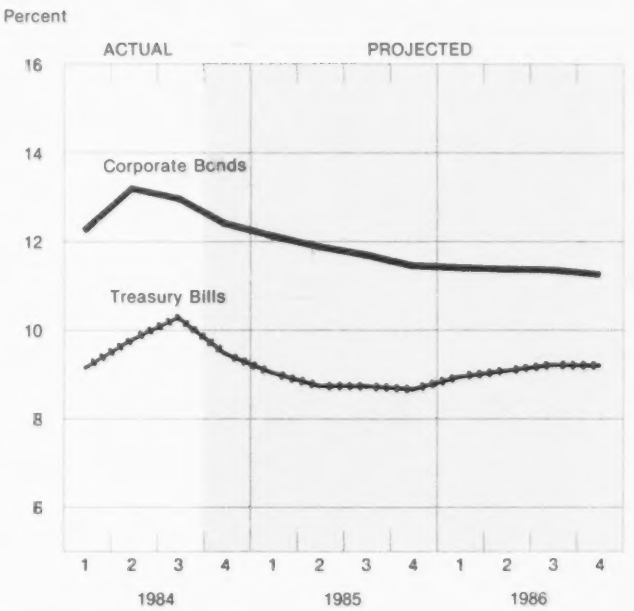
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

and closes the year 1986 at 4.3 percent. Correspondingly, the unemployment rate changes very little between 1984:3 and 1985:1, but then declines to 7 percent by the end of 1985 and to 6.4 percent a year later (Chart 3). The rate of inflation is seen to rise steadily after early 1985, increasing from a 4.2 percent rate in 1985:1 to 5.2 percent in 1985:4 and 5.8 percent in the closing quarter of 1986 (Chart 3).

The growth pattern during the next two years is, in part, a reflection of the pattern of interest rate movements. The rise of interest rates through the late summer of this year contributed to the sharp decline in economic growth during the second half of 1984. The subsequent turnaround in interest rates is a major contributor to the re-acceleration of economic growth during 1985. But short-term interest rates are forecast to bottom out in the second half of 1985 and head up again—though not sharply—during 1986. This shallow-U, or saucer-shaped, pattern to be followed by short-term interest rates over the next two years is basically a reflection of presumed Federal Reserve behavior. Currently, the monetary authorities are assumed to be nudging rates downward to permit the rate of growth to move back up from the 2½-3 percent range. As that happens, accelerating credit demands and a steady-growth-of-reserves policy on the part of the Fed will start to put upward pressure on interest rates which, in turn, will begin to retard demand growth among the most interest-sensitive components of aggregate demand—as shown in Charts 4 and 5.

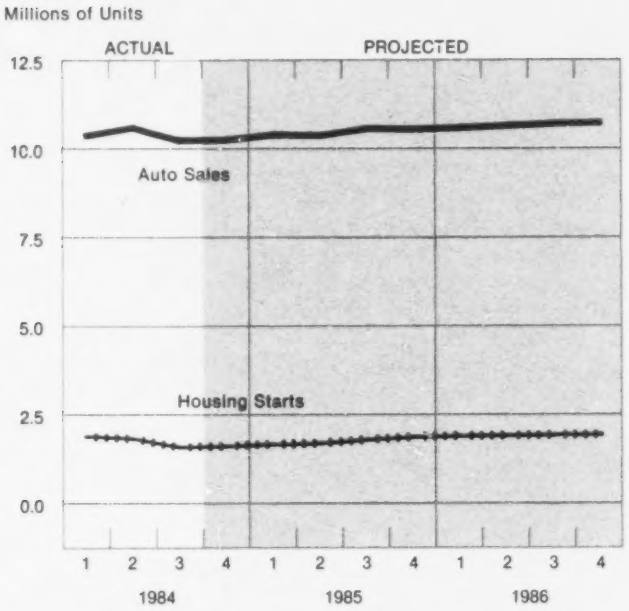
Auto sales and housing starts, for example, are forecast to exhibit nearly identical patterns during the next two years. Auto sales increase from an annual rate of 10.3 million units this quarter to 10.6 million units at the end of next year, rise further to a 10.8 million unit rate by mid-1986, and then remain at that level for the balance of 1986. Private housing starts increase from an annual rate of 1.69 million units this quarter to 1.94 million units by the end of 1985, and then remain virtually flat at or just below a 2 million unit rate during 1986.

CHART 4. Interest Rates for 3-Month Treasury Bills and Corporate Aaa Bonds



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 5. Automobile Sales and New Private Housing Starts



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

The growth of business fixed investment is forecast to remain strong during 1985 and 1986 as businesses continue to react positively to growing final demand and the need to modernize productive capacity (Chart 2). Even so, the rate of increase of real investment declines from an average of 8.8 percent (annual rate) during the first half of 1985 to 5.6 percent during 1986.

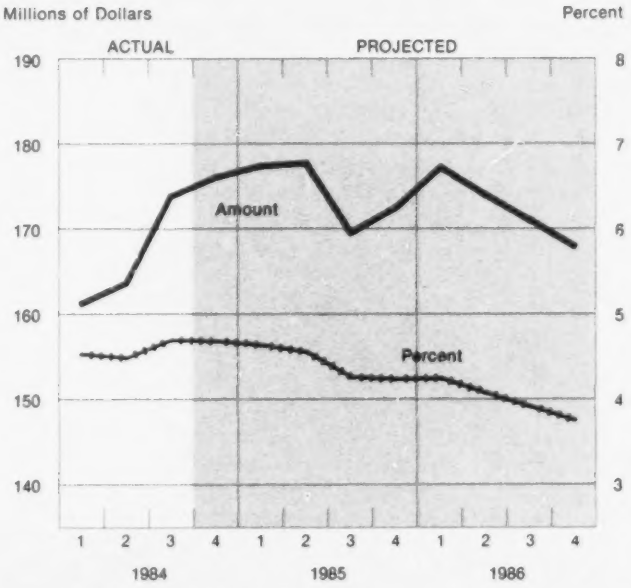
Although not shown in the charts, the path of net exports in the Control Forecast is worth mentioning. The combination of a depreciating dollar, more modest U.S. growth, and somewhat faster growth abroad produces a slow improvement in our real net export position over the next two years. In the closing quarter of this year our real net export deficit is estimated to be about $25 billion in 1972 prices, a year from now it is forecast to be just slightly improved at $22 billion, and in the closing quarter of 1986 the deficit is forecast to be down to $15 billion. The real adjustment over this period is not estimated to be sufficiently rapid, however, to turn around the current dollar imbalance in net exports, though the *rate* of deterioration declines dramatically compared with that of the past year. From 1983:4 to 1984:4 our net export deficit in current dollars is estimated to have risen by $63 billion—up from $30 billion to $93 billion; from 1984:4 to 1985:4 we are forecasting a further increase of $22 billion to bring the deficit to $115 billion, and from 1985:4 to 1986:4 an increase of $11 billion to bring the deficit to $126 billion. It would appear from the quarterly pattern that the deficit would be just about poised to begin to decline in nominal terms two years from now.

Chart 6 shows the pattern of the federal deficit implicit in our Control Forecast, both in absolute and in relative terms. Despite the continued growth of the economy over the next two years "those lines"—i.e., federal spending and receipts—neither meet nor, really, even begin to converge. By our calculations, the deficit—under current tax laws and likely spending programs—remains at a rate insignificantly different from $170 billion throughout the next two years, even with substantial economic growth and reasonably stable interest rates. This does, of course, imply a steady decline in the deficit as a percent of GNP—from 4.7 percent currently to 3.7 percent at the end of 1986. There is a proper sense, therefore, in which the Control Forecast—which involves no new budget actions—implies that the deficit problem will become less serious over the next few years. That is not quite the whole story, however. Despite the shrinkage of the deficit as a share of GNP, federal interest payments continue to absorb a growing percentage of total federal receipts in the Control Forecast. And this aspect of the burden of the federal debt could worsen after fiscal '86, with interest rates remaining relatively high and tax indexation continuing, in effect, to provide annual tax cuts. And, if this is not already complicated enough, it has to be pointed out that the Control Forecast presents a kind of best-case view of the deficit problem, in a sense to be explained in the following section.

The Hidden Assumption in the Control Forecast

In our discussion of federal budget input assumptions, we noted that the Control Forecast contains no legislative actions to reduce the deficit beyond the provisions already present in the Deficit Reduction Act passed in the summer of 1984. Those who maintain that continued high deficits aren't much of a problem might be tempted to read the Control Forecast as evidence in support of such a position. Such an inference would be far too facile. In fact, the Control Forecast—if taken literally—has to be viewed as presuming *both* that no action is taken to reduce the deficit *and*

CHART 6. Federal Government Deficit (NIPA Basis): Amount and Percent of GNP



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

TABLE 3. Selected Economic Indicators as Forecast by RSQE

Seasonally adjusted

ECONOMIC INDICATORS	Quarterly Data										Annual Data			
	ACT.	PROJECTED									PROJECTED			
													% Changes	
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1985	1986	84-85	85-86
GROSS NATIONAL PRODUCT	3,701	3,758	3,827	3,902	3,986	4,078	4,179	4,276	4,377	4,480	3,948	4,328	7.74	9.62
PERSONAL CONSUMPTION EXPENDITURES	2,359	2,413	2,464	2,514	2,567	2,624	2,685	2,745	2,807	2,871	2,542	2,777	8.41	9.22
DURABLE GOODS	317.3	322.9	330.3	336.9	345.8	353.6	362.0	370.0	378.2	385.8	341.7	374.0	7.46	9.47
AUTOMOBILES and PARTS	150.8	153.7	158.2	161.6	167.1	171.1	175.5	179.9	184.2	188.0	164.5	181.9	8.84	10.58
FURNITURE and H.H. EQUIPMENT	115.1	116.9	119.0	121.2	123.7	126.3	129.1	131.6	134.3	136.9	122.5	133.0	6.18	8.54
OTHER DURABLES	51.4	52.3	53.2	54.2	55.1	56.2	57.4	58.5	59.7	60.9	54.7	59.1	6.29	8.21
NONDURABLE GOODS	863.1	883.6	900.0	915.7	931.8	950.6	970.8	990.5	1,011	1,031	924.5	1,001	7.30	8.26
SERVICES	1,179	1,207	1,234	1,262	1,290	1,320	1,352	1,384	1,418	1,454	1,276	1,402	9.48	9.86
GROSS PRIVATE DOMESTIC INVESTMENT	660.5	657.8	660.3	673.5	693.4	716.0	737.8	757.9	778.4	799.0	685.8	768.3	6.77	12.03
NONRESIDENTIAL	431.5	448.7	462.2	473.7	484.9	496.6	508.2	520.6	533.8	547.4	479.4	527.5	12.81	10.04
RESIDENTIAL STRUCTURES	156.6	155.8	158.6	163.7	171.5	179.5	185.8	190.3	194.7	199.0	168.3	192.5	8.75	14.32
CHANGE in BUSINESS INVENTORIES	72.4	53.4	39.5	36.0	36.9	39.9	43.8	47.0	49.9	52.7	38.1	48.3	–	–
NET EXPORTS	−85.4	−93.0	−97.6	−102	−108	−115	−120	−123	−125	−126	−106	−124	–	–
EXPORTS	375.7	382.6	391.3	400.5	410.8	422.0	434.3	447.7	461.7	476.5	406.1	455.0	9.80	12.04
IMPORTS	461.0	475.6	488.8	502.9	519.1	536.6	554.2	570.9	586.9	602.5	511.9	578.6	15.79	13.04
GOVERNMENT PURCHASES	766.9	780.4	799.6	816.6	833.5	852.5	876.7	896.3	916.0	936.2	825.6	906.3	10.24	9.78
FEDERAL	307.7	310.1	318.0	323.4	328.4	335.2	346.9	353.7	360.4	367.2	326.3	357.1	10.42	9.44
NATIONAL DEFENSE	225.4	229.3	236.3	240.2	244.1	249.7	258.9	264.5	270.1	275.8	242.6	267.3	9.16	10.20
OTHER	82.3	80.8	81.7	83.2	84.3	85.5	88.0	89.2	90.3	91.4	83.7	89.7	14.27	7.23
STATE and LOCAL	459.2	470.3	481.6	493.2	505.1	517.3	529.8	542.6	555.6	569.0	499.3	549.2	10.12	10.00
GROSS NATIONAL PRODUCT DEFLATOR, 1972 = 100	224.4	226.4	228.6	230.8	232.9	235.3	238.2	241.0	244.0	247.1	231.9	242.6	3.80	4.60
REAL GROSS NATIONAL PRODUCT (billions of 1972 dollars)	1,650	1,660	1,674	1,691	1,711	1,733	1,754	1,774	1,794	1,813	1,702	1,784	3.80	4.80
AGGREGATE UNEMPLOYMENT RATE (percent)	7.48	7.41	7.41	7.35	7.22	7.04	6.85	6.69	6.55	6.43	7.25	6.63	–	–
CORPORATE PROFITS plus IVA and CCA	284.6	282.5	283.9	292.1	302.9	315.4	326.7	335.2	343.8	353.4	298.6	339.8	5.17	13.79
3-MONTH TREASURY BILL RATE (%)	10.32	9.48	9.05	8.75	8.75	8.68	8.96	9.09	9.23	9.21	8.81	9.12	–	–
REAL DISPOSABLE INCOME (billions of 1972 dollars)	1,175	1,184	1,194	1,204	1,211	1,223	1,237	1,248	1,258	1,269	1,208	1,253	3.42	3.73
PERSONAL SAVING RATE (percent of disposable income)	6.30	5.89	5.67	5.53	5.20	5.27	5.41	5.36	5.32	5.30	5.42	5.35	–	–

Note: All data are in billions of current dollars unless otherwise indicated.

Sources: Projections by Research Seminar in Quantitative Economics, University of Michigan; actual data from Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

that the financial markets and the monetary authorites *don't care* that no action has been taken to reduce the deficit. The latter is thus a hidden assumption in the Control Forecast, and it is rather difficult to accept.

If the 99th Congress fails to take any significant fiscal action to reduce the deficit, we would expect that to result in a far different set of financial and credit market conditions than is contained in the Control Forecast. It is our view that current conditions in the financial sector of the economy are already based on the presumption that the new Congress will follow up on the downpayment put in place by the Deficit Reduction Act. If it were to become clear in the early months of 1985 that such a presumption is unfounded, expectations about future financial conditions would be changed dramatically and adversely. In all likelihood, interest rates would begin to move up sharply long before much of the scenario in our Control Forecast will have unfolded. In that event, the 3 to 4 percent growth rates being forecast for the early quarters of 1985 could well be the peak to be attained before sharply rising interest rates produce a recession in such sectors as residential construction, capital formation, and the purchase of automobiles and other big-ticket consumer durables. Indeed, sharply rising interest rates could also reverse the turnaround in our real net export position, implying yet another source of drag on domestic production and employment.

That is an all-too-familiar scenario, we've experienced it on more than one recent occasion, and there is nothing to recommend it. We believe that the memory of such occasions is all too vivid in the halls of Congress, and that—with the proper packaging—a serious revenue enhancement program will even gain the support of the White House.

How, then, do we interpret the Control Forecast? We envision 1985 as the year in which a major set of tax reform actions begin to work their way through the Congress. There is considerable agreement that the current federal tax struc-

ture is too cumbersome, too inefficient, too unfair, too full of loopholes and abuses—the president is perhaps the leading political spokesman supporting this perception. It also raises too little revenue in comparison with the likely course of federal spending for the foreseeable future. All of these problems can be addressed simultaneously: a major revision of the tax code priced out to phase in higher revenue levels over time.

We would not expect any of this to become effective in 1985 but to begin to be phased in during 1986 as various parts of the package become law. This is the scenario which justifies the relatively calm credit markets implicit in our Control Forecast. The only difference is that our forecast contains none of the tax reform/tax increase legislation which we would expect to begin to phase in during 1986. The economic impact during 1986, however, is likely to be quite small. Purely for illustrative purposes, however, we have made an Alternate Forecast to suggest the kinds of impacts which might be expected from a combination of policies similar to some which appear already to be under tentative discussion.

An Illustrative Deficit-Reduction Package: The Tax Side

Among the tax changes which seem currently to be receiving some attention are:

- the closing of certain tax loopholes, which will broaden the base on which revenue is collected even with existing tax rates,
- a modified indexation of the tax system so that tax brackets are less than fully adjusted for inflation,
- a value-added tax, or VAT, to place part of the tax burden directly on consumption.

For purposes of an alternative calculation, we assume each of the above three tax changes is put into effect to raise additional revenue. Although we have included no other tax changes at the same time, the result in the short run would be little different if these revenue-raising measures were accompanied by a change in the nation's basic tax structure, as long as its total revenue yield were no different than under current law. The specifics of our illustrative tax package are:

- base-broadening which raises $10 billion at annual rate at current income levels,
- an indexation floor of 2 percent so that tax brackets are adjusted to reflect only the excess of inflation over 2 percent per year, and
- a one percent value-added tax on a base that amounts to half of personal consumption expenditures (i.e., certain categories of expenditure such as food and medical care are not subject to the tax). At current expenditure levels this would yield about $12 billion in annual revenue.

Our calculations pertain to a scheme in which all three tax changes are put into effect simultaneously, and we evaluate their effects at the end of four and eight calendar quarters. It is important to note that we have made no offsetting changes in other assumptions at the same time. Specifically, for example, we have not allowed for any changes in monetary policy; the discount rate and growth of the monetary base remain exactly as in the Control Forecast. The results are summarized in Table 4.

The first result to note is that the application of a package of tax increases reduces the level of economic activity. Obviously, this could be counteracted by an accompanying shift toward an easier monetary policy, but we have not allowed for any such change. Two years after the imposition of the tax package, real GNP would have been reduced relative to the Control by more than $12 billion—nearly three-fourths of one percent—and the unemployment rate would be nearly one-fourth of one percentage point higher than in the Control Run.

A good deal of the burden of this tax package hits the consumer sector, both because of the direct tax increases and because the value-added tax pushes up the effective level of consumer prices. Thus, after two years consumer prices are, on the average, nearly three-fourths of one percent higher than they would otherwise be, while real disposable income is 1.6 percent lower than otherwise. The tax package in question tilts the composition of GNP away from consumption.

Interest rates are very slightly lower, but the reason for this is a bit complicated. The simple part is that the deficit has been reduced. The complicated part has to do with two offsetting effects. First, the level of economic activity is lower so that real credit demands are reduced, which should lower interest rates. At the same time, however, with no change in the growth of nominal reserves and a higher price level, real reserves in the banking system grow more slowly, which offsets at least part of the effect of the economic slowdown on interest rates. The net effect is the very small drop in interest rates shown in Table 4.

Finally, of course, a major impact of the tax package is its effect on the deficit, which is down by almost $23 billion at annual rate after one year and by $30 billion after two years.

The real message of this calculation is that a significant shift in the level and slope of the deficit path can be established with only small real effects on the economy. Such a program would provide for a permanent, gradual decline in the deficit and should therefore justify long-term expectations which are consistent with a stable credit environment.

TABLE 4. Economic Effects of Three Revenue Enhancements: Base – Broadening ($10 billion), Indexation Floor (2%), and VAT (1% on half of consumption.)[1]

Indicator	Economic Effects After[2] 4 Quarters	8 Quarters
Real GNP:		
Change in Level (billions of '72 $)	−7.8	−12.5
Percent Difference	−0.5	−0.7
Level of Unemployment Rate (percent)	+0.15	+0.23
Consumption Deflator (percent difference)	+0.6	+0.7
Real Disposable Income (percent difference)	−1.2	−1.6
Treasury Bill Rate (difference in percentage points)	−0.06	−0.08
Federal Deficit (billions of current $)	−22.9	−30.3

[1]The exact tax package is defined in the text.
[2]All economic effects are calculated as Alternate minus (or relative to) Control.

The Surprises of 1983-84 and Scenarios for 1985-86

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A Much Underestimated Expansion

By the last quarter of 1982 the longest slump since the Great Depression of the 1940s had spread through the industrial world causing record unemployment in defiance of many observers who foretold its earlier demise. Yet most forecasters at that time rightly insisted that recovery in the U.S. was imminent, as reported in this space (OUTLOOK, Autumn 1982, pp. 75-77). Subsequent data show that the upturn did start before the year-end as predicted. Indeed, it soon turned out that the recovery was much stronger than had been expected. The median forecasts from the November 1982 ASA-NBER survey were very accurate on the percentage change in current-dollar GNP for 1982-83 but they substantially underpredicted real growth and overpredicted inflation, and the same applies to the simultaneous forecasts for 1982:4-1983:4 (Table 1, columns 1-4). Directionally these predictions were correct, with but two exceptions (lines 5 and 9). One can identify a few real successes in 1982-83 for variables that are difficult to predict (lines 10 and 11). But some very large errors occurred in the forecasts of the rates of growth in industrial production, housing starts, business investment, and profits. The declines in net exports were greatly underestimated.

Forecasters again scored on the average very well with regard to nominal GNP changes during 1984, while aiming too low on real growth and too high on inflation (columns 5-8). Although qualitatively similar, numerically their predictions for the second year were in most cases considerably better than those for the first year. In particular, the results for industrial production, the unemployment rate, and real consumption expenditures were reasonably satisfactory. In contrast, forecasts of such variables as corporate profits, housing starts, real outlays on business plant and equipment, and net exports continued to collect large errors. The table shows one directional error for 1983-84 and one for 1983:4-1984:4 (lines 11 and 7, respectively).

Sources of Error

Evidently few economists were sufficiently optimistic when looking a year ahead to a recovery in 1983 and again a year ahead to a continued expansion in 1984. Why? First, the unexpected sequence of two traumatic recessions in 1980 and 1981-82 left some discouraging scars. It seemed that the high interest rates (which were on the whole fairly well anticipated) would, in combination with the slowly but increasingly recognized disinflation, hinder the recovery in business investment and consumer durables. But the economy adjusted to the higher levels of the real rates, while remaining sensitive to large rises in them in the short run. The power of lagged effects of large net tax cuts, on both the demand and the supply side, appears to have been greatly underestimated. Wages and prices increased much less and corporate profits and cash flows much more than expected. Real spending on housing and durable goods turned up early during the 1982 recession and gathered speed as the recovery progressed in 1983. Real outlays on producers' durable

TABLE 1. Annual and Year-Ahead Forecasts for 1983 and 1984: Predicted vs. Actual Changes

Series	1982-83		1982:4-1983:4		1983-84		1983:4-1984:4	
	P (1)	A (2)	P (3)	A (4)	P (5)	A (6)	P (7)	A (8)
1. GNP in current dollars[1]	7.9	7.7	9.4	10.4	10.1	10.8	9.4	9.4
2. GNP in constant dollars[1]	2.4	3.7	3.5	6.4	5.2	6.8	4.3	5.6
3. Implicit price deflator[1]	5.3	3.8	5.6	3.8	4.8	3.8	3.5	5.4
4. Index of industrial production[1]	2.9	6.5	6.6	14.9	9.1	10.7	5.3	6.3
5. Unemployment rate[2]	−0.2	0.1	−0.8	−2.1	−1.4	−2.1	−0.8	−1.3
6. Corporate profits after taxes[1]	10.4	21.6	18.4	40.0	24.2	15.1*	15.0	2.1*
7. New private housing starts[1]	30.1	60.4	27.0	33.9	1.2	4.1	4.2	−8.2
8. Consumption expenditures in constant dollars[1]	2.6	4.8	3.4	5.7	4.2	5.3	3.5	4.2
9. Nonresid. fixed investment, constant dollars[1]	−3.7	2.5	1.9	14.2	8.5	20.0	6.9	16.6
10. Change in bus. inventories, constant dollars[3]	7.8	6.8	8.0	31.8	13.3	27.8	8.3	7.0
11. Treasury bill rate (3 months)[4]	−2.5	−2.1	0.4	1.0	0.2	−0.9	0.0	0.2
12. Net exports in constant dollars[3]	−1.8	−17.8	−0.8	−22.1	−6.0	−28.1	−0.2	−17.2

P – predicted; A – actual.

[1]Percent changes. [2]Differences, percent of labor force. [3]Differences, billions of 1972 dollars. [4]Differences, percentage points.

SOURCES: Median forecasts from the ASA-NBER November 1982 survey (columns 1 and 3) and from the November 1983 survey (columns 5 and 7.) Actual values from the December 1984 issue of *Business Conditions Digest* and more recent releases for 1984:4 and 1984.

*Inferred from the most recent data and forecasts (actual values for 1984:4 not yet available).

equipment, spurred on by these developments and an especially favorable tax treatment, rose promptly and steeply, exceeding the forecasts by large margins.

The dollar was widely expected to weaken, which would bring on more inflation than the Fed would be likely to tolerate. Instead, the dollar rose to record levels and stayed high, helping to keep inflation relatively low. The growth rates of M1 and M2 declined, but real money balances rose fast late in 1982 and steadily thereafter. The income velocity of money, having dropped at a surprising pace during the recession, stabilized and increased moderately. The large declines in exchange rates for foreign currencies, resulting in record low import prices, generated a great expansion of imports and a continuing weakness of exports of goods and services. This hurt badly many primary producers in manufacturing, mining, and farming. At the same time, however, sectors superior to or shielded from foreign competition prospered and expanded rapidly, notably the information-related "high tech," sophisticated distribution, and other service industries. Prices of services remained relatively strong, but those of sensitive materials have been weak for a long time and actually declining since early 1984 (in large part reflecting the movements of exchange rates). In the past, such developments would betoken a recession, but now the changed structure of the U.S. economy is such as to restrict the hardships to some industries, occupations, and regions. The expansion is still hindered thereby but no longer stopped in its tracks.

Finally, the persistence of huge Federal budget deficits proved to be a long-term, not an immediate problem. In the short run, their effect was the usual one of making fiscal policy on balance definitely stimulative. True, the explosion of government borrowing helped to keep interest rates high, but the inflow of foreign capital, continually attracted by high and apparently safe returns on dollar investments, mitigated the results.

It is easier to forecast annual than quarterly changes, just as it is easier to hit larger and more slowly moving targets. The survey averages of November 1983 predicted an even growth during 1984; but actual output soared in the first quarter, grew less but still strongly in the second, quite weakly in the third, and just about as predicted in the last quarter (Table 2). Thus errors of over-, then underprediction resulted, extending to real consumption and industrial production. The declines in the unemployment rate and rises in plant-and-equipment investment were rather consistently underestimated; the downturns in corporate profits and housing starts were missed. The quarterly forecasts of the volatile movements in inventory investment and net exports generated large random errors.

Of course, in subsequent surveys closer to the target quarters the forecasters were on the average able to improve their predictions of most of these short-term changes. But the unanticipated sharp decline of growth in 1984:3 led many to lower their forecasts for the next quarter, which proved wrong in the light of data now available.

Mixed Signals from Indicators . . .

While the estimate of the annual rate of growth in real GNP for 1984:3 was reduced from 1.9 percent to 1.6 percent, that for 1984:4 was raised from 2.8 percent to 3.9 percent. The implicit price deflator rose 2.3 percent in 1984:4, less than in 1984 as a whole (3.8 percent). The favorable end-of-year news is still subject to revisions.

Most of the recent readings on monthly coincident indicators have been positive, too. The composite index of the four main series in this category gained 0.8 percent in November and 0.9 percent in December, reflecting some moderate rises (industrial production) and some rather handsome ones (nonfarm employment). However, the unemployment rate rose from 7.1 percent of the civilian labor force in November to 7.2 percent in December and 7.4 percent in January. Unless output growth reaccelerates above the average rates of the second half of 1984, unemployment rates will not go down.

The downward trends in interest rates, which began in July-August as the economy weakened, were helped along more recently by easier Federal Reserve policies and have continued through the day of this writing. In the last week of January, the Treasury bill rate stood at 7.7 percent, the Federal funds rate at 8.1 percent, and the average prime rate

TABLE 2. Quarterly Forecasts for 1984: Predicted vs. Actual Changes

Series	1983:4-1984:1		1984:1-1984:2		1984:2-1984:3		1984:3-1984:4	
	P (1)	A (2)	P (3)	A (4)	P (5)	A (6)	P (7)	A (8)
1. GNP in current dollars[1]	2.3	3.5	2.2	2.6	2.3	1.4	2.3	1.6
2. GNP in constant dollars[1]	1.1	2.4	1.1	1.7	1.1	0.4	1.0	1.0
3. Implicit price deflator[1]	1.4	1.1	1.3	0.8	1.3	1.0	1.3	0.6
4. Index of industrial production[1]	1.3	2.7	1.3	2.1	1.6	1.5	0.9	−0.2
5. Unemployment rate[2]	−0.3	−0.6	−0.1	−0.4	−0.2	0.0	−0.2	−0.3
6. Corporate profits after taxes[1]	3.5	6.7	3.9	−0.3	3.7	−7.3	3.1	1.6*
7. New private housing starts[1]	2.4	15.9	0.6	−3.7	2.9	−12.2	−1.4	−6.3
8. Consumption expenditures in constant dollars[1]	0.9	1.1	0.8	1.9	0.9	0.1	0.9	1.0
9. Nonresid. fixed investment, constant dollars[1]	1.4	4.8	2.1	5.0	1.7	3.7	1.6	2.7
10. Change in bus. inventories, constant dollars[3]	−0.1	24.4	2.4	−11.3	0.0	9.7	1.1	−16.4
11. Treasury bill rate (3 months)[4]	−0.2	0.3	0.0	0.7	0.1	0.5	0.1	−1.4
12. Net exports in constant dollars[3]	−1.0	−10.3	0.4	−3.1	−0.4	−15.6	0.8	11.8

For notes and sources, see Table 1.

TABLE 3. Average Forecasts from Surveys of December 1984-February 1985, Ten Aggregate Variables, Quarterly and Annual, 1984-1986

Date of Forecast	Quarterly Forecasts Targets					Annual Forecast Targets		
	1985:1 (1)	1985:2 (2)	1985:3 (3)	1985:4 (4)	1986:1 (5)	1984 (6)	1985 (7)	1986 (8)
Gross National Product in 1972 Dollars (% change, annual rate)								
December 1984	3.2	3.8	3.5	2.9		6.7	3.2	
January 1985	3.3	4.2	3.8	3.1	2.4	6.7	3.4	2.8
February 1985	4.1	4.3	4.0	3.4	2.5		3.9	3.0
GNP Implicit Price Deflator (% change, annual rate)								
December 1984	4.4	4.2	3.9	5.8		3.8	4.2	
January 1985	4.3	4.2	4.4	4.9	5.1	3.9	3.8	4 9
February 1985	3.9	3.7	4.0	4.4	4.6		3.6	4.6
Rate of Unemployment (% of civilian labor force)								
December 1984	7.3	7.2	7.2	7.2		7.5	7.2	
January 1985	7.3	7.2	7.1	7.0	7.0	7.5	7.1	7.1
February 1985	7.2	7.0	6.9	6.8	6.9		7.0	6.9
Corporate Profits After Taxes (% change, annual rate)								
December 1984	10.6	17.1	11.7	2.6		13.5	2.4	
January 1985	11.8	18.4	14.8	4.3	0.2	14.2	3.9	5.3
February 1985	15.2	20.5	12.2	5.5	1.0		4.4	5.8
Industrial Production Index (% change, annual rate)								
December 1984	4.1	4.4	4.0	2.8		11.1	4.0	
January 1985	4.4	4.6	4.7	3.4	2.5	10.1	3.8	3.0
February 1985	5.9	5.8	4.9	3.6	2.5		4.0	4.1
New Housing Starts (% change, annual rate)								
December 1984	13.6	8.4	− 2.5	− 3.2		4.2	− 6.0	
January 1985	29.1	17.2	0.2	− 3.4	− 7.3	4.7	− 3.3	− 2.7
February 1985	30.7	23.3	5.3	− 3.8	− 2.9		− 0.9	1.2
Treasury Bill Rate, 3 Months (percent)								
December 1984	8.6	9.0	9.3	9.5		9.6	9.1	
January 1985	8.2	8.6	8.9	9.1	9.2	9.6	8.7	9.1
February 1985	7.9	8.2	8.6	8.8	8.8		8.4	8.7
Nonresidential Fixed Investment in 1972 Dollars (% change, annual rate)								
December 1984	8.4	7.4	6.6	5.6		19.9	9.4	
January 1985	8.2	7.0	6.4	6.0	5.4	19.9	9.3	4.9
February 1985	7.7	7.0	6.8	6.6	4.9		9.6	5.4
Change in Business Inventories, 1972 Dollars ($ billion)								
December 1984	18.3	18.0	18.2	17.9		25.9	18.2	
January 1985	18.3	18.6	18.9	18.8	16.9	25.9	18.7	15.3
February 1985	15.5	17.0	18.0	18.3	16.7		17.2	16.9
Net Exports of Goods and Services, 1972 Dollars ($ billion)								
December 1984	−26.9	−27.4	−27.4	−26.8		−18.0	−27.2	
January 1985	−23.6	−24.2	−24.4	−24.2	−24.1	−17.5	−24.1	−22.5
February 1985	−18.5	−20.5	−22.0	−22.1	−21.5		−20.7	−19.9

SOURCE: *Economic Forecasts: A Worldwide Survey*, Elsevier Science Publishers (North-Holland), Volume 1, No. 6, December 1984; Volume 2, No. 1, January 1985; worksheet tabulations for Volume 2, No. 2, February 1985.

December 1984: means of 26 individual forecasts; January 1985: means of 30 individual forecasts; February 1985: means of 30 individual forecasts.

at 10.5 percent, down from the summer peaks of 10.5 percent, 11.6 percent, and 13.0 percent, respectively. Since late October, after a pause of about five months, growth in checkable deposits and M1 have resumed at a fair pace but time deposits have flattened.

The retardation of 1984:3 was preceded by downturns in the leading index and inventory investment as well as several months of rising interest rates. The weakness was caused in large part by a decline in real consumption expenditures, particularly on durables. But in 1984:4 these consumer outlays turned up again and recorded large gains. Consumer confidence, though weakened, remained relatively high. Business investment in plant and equipment continued moving up, albeit at a reduced pace. At present, however, some data relating to future domestic production and investment give cause for concern.

The signals from these and some other leading indicators are mixed, pointing to uncertain prospects. According to the Commerce survey taken earlier in the fall, businesses planned to increase their total spending on capital goods by

6.8 percent in the year 1985 compared with 1984, after adjustment for projected inflation. But constant-dollar contracts and orders for plant and equipment have followed a mild and irregular downward drift for several months now. So have new orders for consumer goods and materials in 1972 dollars. These series do not include orders from foreign producers, which have been rising. Sales of automobiles and of existing homes increased strongly in the final months of 1984. But residential construction commitments and expenditures continue to be weak.

The composite index of 12 leading indicators rose to a high of 168.5 (1967 = 100) in May 1984; it then moved down to 163.9 in August, up to 165.2 in September, and again twice down in the last quarter to 164.9 in December. Such oscillations signify a weakness but not a decisive downturn. The January Wall Street rally reflects a new surge of optimism among both the big institutions and small investors. There is an eagerness, often observed in the past, to embrace the good news and downgrade or reject the bad news.

. . . But Most Observers Encouraged, Expect Further Improvements

In late November, the date of the last business outlook survey taken by the American Statistical Association and the National Bureau of Economic Research (the results of which are shown in this OUTLOOK issue), the economy was showing few signs of coming out of the sharp economic slowdown of mid-1984. Nevertheless, most of the 31 respondents predicted real growth of more than 3 percent next year. Chances of a slide into recession were rated by all but a few as low, though generally not negligible. Some rises in the unemployment rate were anticipated but on balance slight declines prevailed. About 60 percent of the survey participants expected that inflation and interest rates will be higher in 1985:4 than in 1984:4. However, the projected changes were on the whole small and the responses to them were not seen as posing a threat to the expansion in the near future.

Table 3 sums up the results of three monthly surveys that are more recent than the last ASA-NBER questionnaire. The source, a new monthly journal *Economic Forecasts: A Worldwide Survey* (North-Holland), provides comprehensive coverage and full detail on individual forecasts, but here only the group averages are used. As in the ASA-NBER survey, judgmental, econometric, and combined forecasts are represented, and the participants include many persons and organizations familiar to the business and financial community.

New and revised data for quarterly, monthly, and shorter periods are being released almost daily: the continuous change creates demand for more frequent forecasts that permit more flexibility of adjustment to the often surprising turn of events. Predictions that are closer to their target period use more up-to-date information and tend to be more accurate. Still another good reason for monitoring monthly forecasts is that they show promptly how expectations vary and change.

Clearly the general outlook improved significantly as shown by the evolution of the survey forecasts published in December 1984 and January and February 1985. All average forecasts of rates of growth in real GNP and industrial production are higher now than they were one and two months ago. The same is true of most predictions of corporate profits. The forecasts of unemployment rates have been revised downward; so have those of inflation (IPD) and interest (Treasury bill) rates.

These changes, however, are on the whole not large. There is little anticipation that the exuberance of early 1984 is coming back. Real growth is expected to be moderate through the summer, at or slightly above 4 percent annual rates, then to decline again to near 3 percent and lower late in 1985 and 1986. This is attributable to upward drifts in inflation and interest rates, a downturn in housing, a weakening of investment in plant and equipment and business inventories, and continuing large trade deficits.

Also, there is still much uncertainty about the outlook, and the dispersion among the individual forecasters is substantial. The predominant moderately optimistic scenario is not without its risks and rivals. Worries about the high federal budget deficits are widespread. If Congress fails to take any effective action on the problem, then, according to some forecasts, interest rates may move up sharply late this year and in 1986. The strong dollar and high imports, too, would continue to hurt large sectors of U.S. economy. The result would be a recession, perhaps only late next year.

Another possibility is that large cuts in government spending are enacted, and perhaps the effective tax burden is also raised. Interest rates should then decline, but some analysts think that this would occur only with considerable lags. In the meantime, the economy would be pushed into a slowdown or recession.

Finally, there are some who foresee stronger and more sustained growth, less actual and expected inflation, more moderation of wages, and lower deficits and interest rates as a result. This highly optimistic scenario, however, is evidently given a low probability by all but a very few forecasters.

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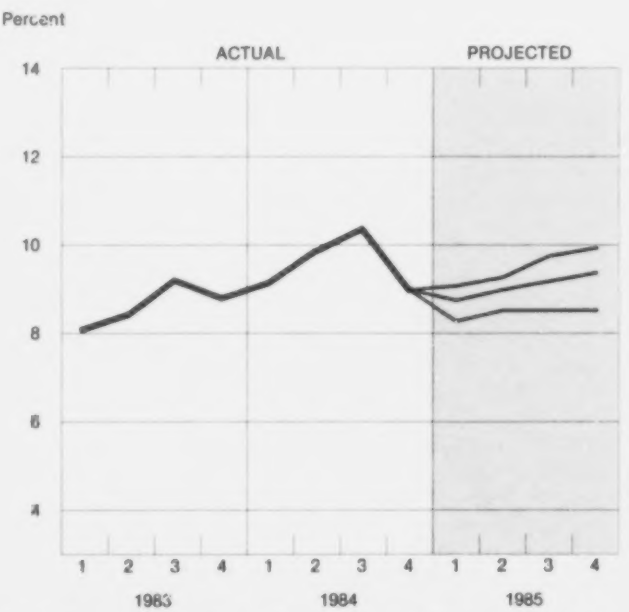
3-MONTH TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

A Recession Narrowly Averted?

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Can Economists Forecast?

No less an authority than the President of the United States has been quoted as declaring that there is not an economist in the world who can accurately forecast long-term budget data. He might even have had in mind a truncated version of this pronunciamento—namely, that economists can't forecast. He would, of course, be right. As for the budget, the Budget Message transmitted in January 1979 projected for fiscal year 1984—in the five-year lookahead required by law—outlays of $674 billion, receipts of $780 billion, and a surplus of $106 billion. Things did not, as the whole world knows, turn out that way. The bottom-line figure was, of course, in red ink to the tune of $175 billion.

There are two problems about citing this as evidence that "economists" cannot forecast budget data or forecast more generally. One is that political actions in any five-year span keep altering the budget path. What "the economists" project, and they do it reasonably well, is how the budget would look five years hence if spending and revenue programs were unchanged. More fundamentally, good policy decision-making in government or in business requires making some assumptions about basic underlying trends. The capital budgets of a corporation, or even its operating plan for "next year," imply some assumptions about trends in economic activity. Any board of directors will (or should) insist that these assumptions be made explicit, but any board of directors worthy of its responsibilities also knows that these assumptions and plans will require modification as added information becomes available.

And both ends of Pennsylvania Avenue would do well to judge the value of these projections on a more fundamental basis than whether government economists "predict" future budget figures accurately. We have an uncomfortable budget problem today because government took inadequate account of where these earlier decisions were taking the budget for several years ahead. Indeed, a budget process which focuses only on "next year" will be an exercise in futility since spending "next year" will largely be determined by program decisions already made. The President and the Congress can "today" have some but limited influence on the budget path if they focus on the forthcoming fiscal year (FY 1986); they can *control* the direction of that path only by focusing on the several years ahead.

Problems at Year-End 1984

As we moved out of 1984, business analysts were clearly beginning to feel some butterflies about economic prospects, and they were not just being Nervous Nellies. The strength that the economy had displayed earlier in the year seemed to fade after mid-1984, and the news that real "final demand" in the third quarter actually declined was decidedly unsettling. Moreover, other information seemed to corroborate this adverse dog-leg in business conditions. Monthly reports from the National Association of Purchasing Management showed the proportion of the responding firms reporting an increase in new orders exceeding the proportion reporting a decline by 20 to 40 percentage points during the first half of 1984 (Table 1). This net favorable percentage dropped in the third quarter, and in the fourth quarter the proportion reporting a decline in new orders exceeded the proportion reporting an increase—the largest net unfavorable figure coming at the end of the year.

TABLE 1. Net Percent* of Firms Reporting Increases, 1984

Month	Production	New Orders	Inventories
Jan.	+24	+27	+ 3
Feb.	+37	+41	+13
March	+36	+35	+12
April	+38	+40	+18
May	+20	+14	+10
June	+25	+20	+12
July	+ 2	+ 2	+16
August	+ 6	+ 4	0
Sept.	+ 4	− 2	− 7
Oct.	+ 3	− 1	−15
Nov.	+ 2	0	−15
Dec.	− 5	− 5	−14

*Percent reporting an increase less percent reporting a decline.
Source: National Association of Purchasing Management.

There were other indications that the forces for economic expansion might be less monolithic than seemed probable earlier in the year. The two major leading indicator indexes seemed to be on a declining trend after early-year peaks. With average lags, these in the mechanistic sense seemed to be pointing to a peak for business activity generally around the end of this year's first quarter. Since the first quarter has not yet faded into history, we cannot be sure that this peak will not occur, but in the meantime these indicator indexes seem to have changed their minds and started upward again.

Moreover, data for the fourth quarter were generally interpreted to portend more economic strength than was really warranted. While output was rising more rapidly than had been expected, the fact is that over-all demand for output in the U.S. economy was rising at only a one percent per year pace in the final quarter last year (Table 2). This one

TABLE 2. Annual Rates of Increase* in the Demand for Output, 1984

Quarter	Real GNP	Final Demand	Domestic Demand for Output
First	10.0	3.6	12.9
Second	7.1	10.3	7.9
Third	1.6	−1.0	5.4
Fourth	3.9	8.3	1.0

*Percent change computed from data in 1972 prices.
Source: Basic data from the U.S. Department of Commerce.

percent gain in the domestic demand for goods and services here at home translated into a 3.9 percent per year rise in real GNP because there was an unexpected, and possibly temporary, shift in demand from imports to domestically produced stuff. Indeed, imports of goods and services, in real terms, declined at a 27 percent per year rate in the fourth quarter, but it would be imprudent to assume that this is the beginning of a fundamental shift of demand here at home toward domestically produced services and products.

In these early weeks of the year it looks as if 1985 has probably averted by a narrow margin the distinction of launching the ninth recession since World War II or the sixth in the last quarter of a century. At the turn of the year production and employment were expanding at a good rate. Inventories were not overly heavy relative to sales and sales prospects. Consumers were continuing to be prudent in the allocation of their after-tax incomes between spending and saving.

Factors Affecting Continued Expansion

Whether we can keep the expansion going on a sustained and orderly basis will depend on three sets of factors. First, sounding like a broken record though it may, we ought to avoid the zigs and zags of monetary policy with which the economy had to contend once again in 1984. The money stock (M-1) increased at an 8.2 percent per year rate in the first half of last year, but from mid-year to October the trend was flat to slightly downward—only to be followed by a spurt at the turn of the year. The 5.7 percent average rise during the year was appropriate, but swings in this rate during the year were too wide. These swings, particularly the complete cessation of growth after mid-year, had to have exerted an adverse effect on business conditions in the short run, and they thus also were generating demands for more direct political control of the management of the Federal Reserve System. Monetary policy would not then, of course, be managed better (indeed, worse), so it is important to remove this source of that pressure also.

Second, the expansion must move cautiously from here on, because the one development that would start the beginning of its obituary would be to reactivate a rising trend in the rate of inflation—which was disastrous in so many ways during the last decade. Reducing the unemployment rate below present levels can be done, but it requires more careful and patient navigating than was needed during the decline from 10 percent a few years ago to the 7 percent of today. Fortunately, there the performance remains good. The rate of inflation during 1984 was in the 3½ percent per year zone, and hourly earnings (with the influence of changing employment patterns eliminated) were rising at about the same (or slightly lower) average rate. Thus the year ahead of us inherits as an important and favorable legacy a reasonably benign trend in our cost-price level.

Finally, we must make major progress in relieving the distortions imposed on the U.S. economy, and on the world economy also, by the sharp rise in the exchange rate of the U.S. dollar. While the causes of these sharp changes in the exchange rate for the dollar are complex, a major influence clearly has been the large deterioration in the Federal budget (Table 3). The basic problem is that the savings required by the private economy plus the Treasury's borrowing requirements are 10-15 percent more than the volume of savings generated domestically. The market for savings is like the market for corn or semiconductor chips or oil. The price will move to the level where the supplies made available are brought into balance with the amount demanded. In this case the price, rates of interest, here at home must be high enough to attract the foreign savings needed for things to balance out. When a foreigner places funds here, however, he accepts all of the risks of the domestic investor plus the foreign exchange risk that when he wants to take his funds back home a weaker exchange rate for the dollar might mean winding up with fewer francs, or D-marks, or yen. Since these foreign savings come in by the purchase of dollars, the price of the dollar is pushed up. The result is that the real effective exchange rate of the dollar is now about one-third above its 1977-80 level, our net export surplus of manufactured goods of about $5 billion per year at the turn of the decade was an $80 billion deficit last year, and U.S. manufacturing employment last year was 4 percent below that of 1980, though non-manufacturing employment was up 5 percent.

It is essential that this external imbalance be redressed before the rest of the world becomes too comfortably adjusted to what for them is a favorable trade balance with the U.S.—but which for economic and political reasons will not be tolerable here at home for the long run.

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TABLE 3. Factors Associated with U.S. External Trade Deficit

Year	U.S. Export Surplus[1]		Exchange Rate of Dollar[2]	Federal Surplus[3]	Aaa Bond Yields[4]
	Total	Mfg. Gds.			
1977	$ – 39.2	$ 3.6	102.9	$ – 53.6	8.02
1978	– 42.4	– 5.8	98.4	– 59.2	8.73
1979	– 40.4	4.4	98.4	– 40.2	9.63
1980	– 36.4	18.8	102.2	– 73.8	11.94
1981	– 39.7	11.8	112.8	– 78.9	14.17
1982	– 42.7	– 4.3	123.2	– 127.9	13.79
1983	– 69.4	– 31.0	126.3	– 207.8	12.04
1984p	– 123.0	– 83.0	132.0	– 185.3	12.71

[1]In billions, from U.S. Department of Commerce.
[2]Index of real effective exchange rate, from *World Financial Markets*, December 1984 and earlier issues. Data converted to a base of 1977-80 = 100.
[3]In billions, for fiscal years.
[4]Moody's Aaa bond yields, *Economic Indicators*, December 1984, p. 30.
p – preliminary.

Improved Finances Sustain Consumer Optimism

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Changes in Sentiment

In the fourth quarter 1984 survey, the Index of Consumer Sentiment was 95.0, down from 98.9 one quarter earlier, and the cyclical peak of 99.5 recorded in the first quarter of 1984 (see the chart below). Despite this small year-end decline, the average level of consumer confidence recorded during 1984 was higher than in any prior year since the late 1960s.

Most periods of recovery in consumer sentiment mirror past cycles, at least in the structure if not in the extent of change in attitudes. Only infrequently does a new underlying foundation emerge. The current recovery has been accompanied by a shift in the criteria used by consumers to judge the current and expected performance of the economy. Whether this shift in the structure of sentiment endures or is only temporary will depend on subsequent reinforcement. Nonetheless, the older sentiment patterns are now being held in abeyance, the precondition for the emergence of a new belief structure.

From the mid-1950s to the mid-1960s, income and employment trends dominated consumer assessments of the economy. From the mid-1960s through the decade of the 1970s, inflation was the dominant yardstick. By the mid-1980s, interest rates became the most common basis on which assessments were made and the primary source of uncertainty about the future course of the economy. To be sure, the problem of inflation is not viewed by the public as having been resolved, but the remission is expected to continue. Little credence is given to the once common scenario of a stagnant economy and declining living standards. And little credence is given to predictions of uninterrupted growth during the decade ahead. That the economy will experience periods of both growth and recession in the future is not in question. Rather, we have experienced a change in how people assess ongoing economic developments.

When asked about their future financial prospects, three factors have dominated consumer evaluations, at one time or another, during the past several decades: employment prospects, wage trends, and trends in the cost of living. During the past few years, the rate of increase in both wages and prices has moderated to a substantial extent, while unemployment remained at relatively high levels. As a result, job prospects now constitute the most important source of uncertainty about financial prospects for individual families. And because of smaller expected increases in wages and prices, the real burden of future debt repayments, as well as the real return to savings, is now more dependent on trends in market rates of interest. Moreover, this shift from an economy characterized by inflation to one with high and variable interest rates has also influenced purchase timing decisions. Borrowing-in-advance of rising interest rates rather than buying-in-advance of rising prices has emerged as one means of adapting old responses to new situations.

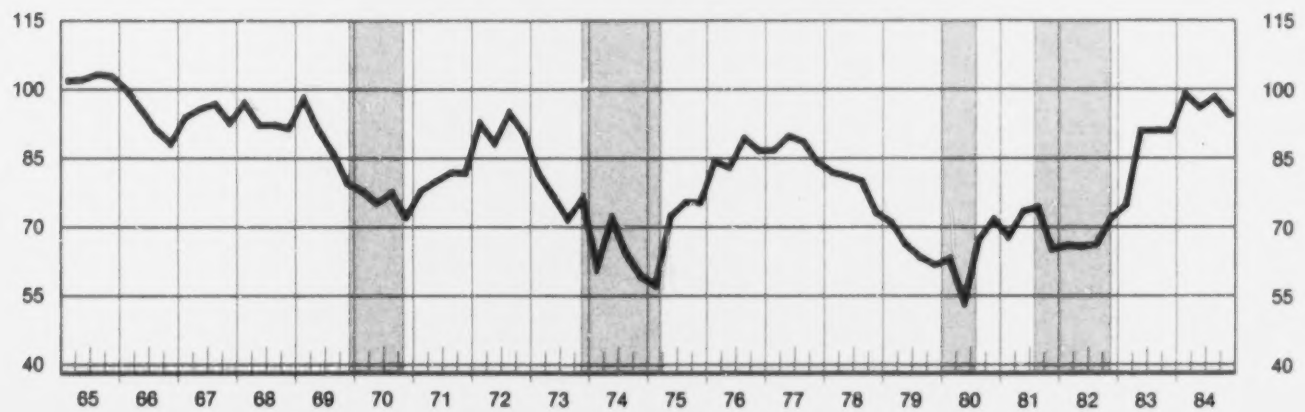
Best Financial Progress in 20 Years

The personal financial situation of American families improved to a greater extent in 1984 than in any other year in the prior two decades. Among all families in the fourth quarter 1984 survey, 44 percent reported that their financial situation had improved, just below the 45 percent recorded in each of the first three quarters of 1984. In comparison, the 1972 and the 1965 peaks were slightly higher, but these favorable levels were only sustained for one quarter – 47 percent in the second quarter of 1972 and 50 percent in the second quarter of 1965.

When asked to explain how their financial situation had improved, 35 percent of all families reported that their income had increased in the fourth quarter survey, a level that remained largely unchanged throughout 1984. In addition to more favorable trends in nominal incomes, fewer families

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

complained about the erosion of the purchasing power of their incomes due to inflation during 1984 than in any prior year since the late 1960s.

American families have viewed prospects for improvement in their financial situation very favorably since the start of 1983. In the fourth quarter 1984 survey, 38 percent of all families expected their financial situation to improve during 1985, just above the 37 percent that expected improvement one year earlier. Just 11 percent of all families in the fourth quarter 1984 survey expected their financial situation to worsen during the year ahead, unchanged from the fourth quarter 1983 reading. On balance, personal financial expectations have remained near cyclical peak levels for nearly two years.

The sustained optimistic outlook for personal finances has not been based on higher income expectations, but rather on the expectation that inflation would continue to remain at low levels. The proportion of families in the fourth quarter 1984 survey that expected income increases of 6% or more was 34 percent, just above the 32 percent recorded one year earlier, but below the 37 percent that was recorded two years earlier. During that same time, the proportion of families that expected an annual rate of inflation of 6% or more fell from 32 percent in late 1982 to 24 percent in the fourth quarter of 1984. As a result, in 1984 families held the most favorable real income expectations during the past ten years.

Given that these favorable financial prospects are based on low rates of inflation and limited income increases, consumers have adopted a somewhat more cautious outlook toward use of savings or debt to finance major purchases. The future burden of debt repayments will not be eased by rapid inflation, nor will the value of accumulated savings erode as quickly as was the case in the late 1970s. Among all families in the fourth quarter survey, 36 percent said that they were willing to use part of their savings in order to make major purchases, down from 42 percent six months earlier, and just above the 35 percent recorded one year earlier. Willingness to incur new debt was reported by 27 percent of all families in the fourth quarter of 1984, down from 29 percent six months earlier, and just above the 25 percent one year earlier.

Becoming Accustomed to Expansion

The majority of consumers have viewed the progress made by the national economy in very favorable terms throughout 1984. Among all families in the fourth quarter survey, 64 percent thought that economic conditions had improved during the past year, just below the 67 percent recorded both one quarter and one year earlier. Although the proportion that reported improved business conditions has declined from the cyclical peak of 71 percent at the start of 1984, at year end it still remained higher than at prior cyclical peak levels.

Given that these very favorable evaluations of the performance of the economy have lasted for nearly two years, it is no surprise that the widespread enthusiasm which greeted the initial phase of recovery has now been transformed into an accustomed awareness. Soon after the recovery first took hold in early 1983, the proportion of families reporting that they had recently heard of favorable economic developments reached an all-time peak of 80 percent. By the end of 1984, only half as many respondents reported hearing of favorable economic developments (41 percent). This decline in perceptions of ongoing developments has been due to both economic and psychological factors.

As the expansion period lengthened, developments that initially commanded widespread recognition and prompted sharp upward revisions in sentiment gradually lost their impact through the process of habituation. As people became accustomed to favorable developments, even the once constant attention given to these developments waned. The rising proportion of families that said they had not heard of any recent economic developments, either favorable or unfavorable, reflects this process of habituation – up from 30 percent in early 1983 to 46 percent by the close of 1984. At the same time, there was no substantial resurgence in perceptions of unfavorable developments; the proportion of families that reported hearing of unfavorable developments only rose from 31 to 38 percent. Although habituation does decrease the public's attention to the continuation of favorable trends, it also acts to insulate current attitudes and expectations from change. Change requires the repeated acquisition of information on *new* developments that cast doubt on the accustomed pattern.

Job Prospects Top Concern

The small overall rise in reports of unfavorable developments at year end was focused on changing job prospects. In the fourth quarter 1984 survey, 14 percent mentioned hearing of news of increases in employment, down from 26 percent at the start of the year, while reports of increases in unemployment rose to 17 percent at year end from 12 percent in the first quarter of 1984.

The negative shift in reports on recent employment trends was accompanied by less favorable job prospects for the year ahead. In the fourth quarter 1984 survey, for the first time in two years, the proportion of families that expected a decline in the aggregate unemployment rate fell below the proportion that expected the unemployment rate to increase. Among all families, 21 percent expected declines in unemployment during the year ahead, compared with 25 percent that expected increases. At the start of 1984, more than twice as many families expected declines rather than increases in unemployment (35 versus 15 percent). Importantly, the majority of families (52 percent) expected the unemployment rate to post neither an overall increase nor decrease during the year ahead, but to remain at its current relatively high level.

Prospects for the Economy: Diminished but Still Favorable

The outlook for the general economy remained largely unchanged at favorable levels during the last nine months of 1984. In the fourth quarter survey, twice as many families expected further improvement rather than reversals in the national economy during the year ahead (33 versus 16 percent). Consumers, however, do not expect the same rapid rate of economic growth for 1985 as they did for 1984 – at the end of 1983, four times as many families expected improved economic conditions (45 versus 10 percent).

Despite the expected slowdown in the pace of economic growth, the majority of families expect good times financially in the economy as a whole to persist in both the near and longer terms. Among all families in the fourth quarter 1984 survey, 59 percent expected the economy to perform well during the next twelve months, just below the 63 percent recorded one quarter earlier and the 61 percent recorded

one year earlier. Economic prospects over the longer term have also remained favorable. In the fourth quarter 1984 survey, 42 percent of all families expected good times financially over the next five years, down from 46 percent one quarter earlier, but above the 39 percent recorded one year earlier. Long-term economic expectations were favorable on balance during the entire year of 1984 – for the first time since the late 1960s.

Confidence in government economic policies to reduce both inflation and unemployment was higher in the fourth quarter 1984 survey than at any prior time during the past decade. Among all families, 33 percent favorably rated government economic policies, unchanged from the third quarter reading and above the 27 percent recorded one year earlier. Unfavorable evaluations of government economic policies were given by 18 percent of all families, down from 21 percent one year earlier.

Interest Rate Declines Encourage Home Buying

Attitudes toward buying conditions for homes improved by a small amount at year-end 1984. Among all families, 53 percent held favorable home-buying attitudes in the fourth quarter survey, up from 50 percent one quarter earlier, but below the 61 percent recorded at the start of 1984. In early 1984, when interest rates were widely expected to increase, favorable home-buying attitudes were supported in part by the appeal of borrowing-in-advance of those increases. Since mid-1984, as interest rate expectations have declined, so has the appeal of borrowing-in-advance, falling to 9 percent at year end from 20 percent six months earlier. The improvement at the close of 1984 was due to more frequent references to the current availability of lower mortgage rates, rising to 30 percent in the fourth quarter from 22 percent in the third quarter of 1984. References to high mortgage rates as a cause for postponement fell to 31 percent in the fourth quarter from 38 percent one quarter earlier, but remained above the 28 percent recorded one year earlier.

How consumers evaluate trends in buying conditions for homes has undergone a fundamental shift during the past several years. The pace and breadth of the housing boom of the late 1970s was propelled by expected future price increases. In that environment, sharp rises in housing prices only reinforced the appeal of advance buying. At that time, purchase timing was dominated by price expectations. At the current time, purchase timing has become more sensitive to trends in interest rates rather than prices. Although reactions to rising interest rates and tight credit conditions have repeatedly caused declines during past cycles, only since 1980 have interest rate declines greatly stimulated favorable buying attitudes, and expected interest rate increases stimulated borrowing-in-advance rationales.

Interest rate expectations, following sharp increases in early 1984, posted significant declines in the second half of the year. Among all families in the fourth quarter 1984 survey, 42 percent expected interest rates to increase, down from 55 percent in the third quarter and 66 percent in the second quarter. The proportion of families that expected interest rates to decline was 24 percent in the fourth quarter, up from 9 percent two quarters earlier. Despite the substantial recent improvement, interest rate expectations remained somewhat less favorable at year-end 1984 than at the close of 1983.

Price Discounts on Durables Attract Buyers

Favorable perceptions of market prices for large household durables have kept buying attitudes at very favorable levels throughout the past year. Among all families in the fourth quarter 1984 survey, 68 percent held favorable attitudes toward buying conditions for durables, between the 71 percent recorded one quarter earlier and the 63 percent recorded one year earlier. In the fourth quarter 1984 survey, the proportion of families that cited the availability of price discounts on household durables was 30 percent, just below the 34 percent recorded one quarter and one year earlier. Unfavorable references to market prices for durables also declined by a marginal amount during the past year – from 16 to 14 percent. On balance, such favorable perceptions of market prices for household durables have not dominated consumer evaluations to this extent in more than 20 years.

Favorable car-buying attitudes were held by 55 percent of all families in the fourth quarter 1984 survey, down from 60 percent one quarter earlier and 58 percent one year earlier. Although the fourth quarter 1984 reading of 55 percent was the lowest reading since the first quarter of 1983, it nonetheless remains at a level comparable with the cyclical peak recorded in the late 1970s. A decline in favorable perceptions of market prices for vehicles was the primary reason for the recent erosion. Among all families in the fourth quarter survey, 18 percent referred to the availability of price discounts on new vehicles, the lowest level recorded in more than three years. Although references to price discounts on vehicles has declined, the number of consumers that registered complaints about high vehicle prices had not increased by year end 1984 over the year-earlier level – 14 percent.

Summary Outlook

The small year-end decline in consumer sentiment indicates the transition from the prolonged enthusiasm which accompanied the rapid recovery to the accustomed awareness of the ongoing economic expansion. Even after this small decline, consumer sentiment remained more favorable at year-end 1984 than at the cyclical peak recorded in the late 1970s. Thus far, most of the decline has been concentrated in movement from expectations for continued improvement toward the expectation that economic conditions would remain largely unchanged, rather than toward unfavorable expectations. Even if there are darkening clouds on the horizon, they are viewed as sufficiently distant so as not to cause concern with prospects in the near term.

These data indicate that consumer spending will be maintained at its improved level through late 1985. But unlike the later stages of past expansion periods, when the unrelenting pressure of rising prices promoted advance buying, buying attitudes have become increasingly dependent on the availability of price discounts. As a result, greater resistance to price increases can be expected, as well as an increased focus on comparative price shopping. Buying behavior has thus become more responsive to pricing of individual sellers rather than to aggregate price trends. Instead of inflation, aggregate trends in interest rates are now the primary influence on the timing of major purchases.

February 1985

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Actual		Proj.
	83:2	83:3	83:4	84:1	84:2	84:3	84:4	84:4	85:1	85:2	85:3	85:4	1983	1984	1985
GROSS NATIONAL PRODUCT	3,267	3,347	3,432	3,553	3,645	3,695	3,764	3,761	3,833	3,900	3,978	4,065	3,305	3,664	3,941
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	214.3	215.9	218.2	220.6	222.4	224.6	226.1	226.6	229.0	231.6	234.2	236.6	215.3	223.4	233.0
CORPORATE PROFITS AFTER TAXES	123.4	142.6	141.1	150.6	150.2	141.7	147.5	145.0	147.2	151.5	155.0	154.0	127.4	147.5	153.0
UNEMPLOYMENT RATE (percent)*	10.17	9.33	8.47	7.87	7.50	7.47	7.20	7.40	7.30	7.20	7.20	7.15	9.58	7.51	7.20
INDUSTRIAL PRODUCTION (index, 1967 = 100)	144.5	151.8	155.5	159.8	163.1	165.6	165.1	166.4	168.0	169.9	171.0	173.0	147.6	163.4	170.1
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.690	1.782	1.699	1.947	1.858	1.663	1.586	1.620	1.655	1.700	1.655	1.660	1.704	1.764	1.660
CONSUMER PRICE INDEX (% change from prior quarter or year)	4.34	4.15	4.43	4.97	3.70	3.58	3.85	4.00	4.05	4.30	4.55	4.65	3.19	4.24	4.30
3-MONTH TREASURY BILL RATE (%)	8.42	9.19	8.79	9.13	9.84	10.34	8.97	9.50	9.25	9.50	9.70	9.90	8.62	9.57	9.53
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	11.57	12.68	12.76	12.94	14.18	13.72	12.76	12.80	12.70	12.50	12.80	12.90	12.25	13.40	12.80
GNP IN 1972 DOLLARS	1,525	1,550	1,573	1,611	1,639	1,645	1,665	1,660	1,674	1,688	1,702	1,715	1,535	1,640	1,695
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	1,006	1,016	1,032	1,044	1,064	1,066	1,075	1,076	1,086	1,095	1,102	1,111	1,009	1,062	1,098
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	165.3	172.6	184.5	193.3	202.9	209.5	212.7	212.0	216.0	220.0	222.3	224.0	171.0	204.6	220.7
RESIDENTIAL FIXED INVESTMENT (1972 $)	53.4	57.2	57.8	60.6	60.8	60.1	59.3	60.0	59.7	60.0	59.0	59.0	53.7	60.2	59.2
CHANGE IN BUSINESS INVENTORIES (1972 $)	−6.1	0.9	7 2	31.6	20.3	30.6	16.8	22.3	20.5	18.7	19.5	19.5	−3.6	24.8	19.6
NET EXPORTS (1972 $)	13.6	11.9	2.0	−8.3	−11.4	−27.0	−10.2	−23.2	−23.0	−23.0	−22.9	−22.4	12.6	−14.2	−23.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	117.2	115.6	113.0	112.2	123.2	125.0	129.6	128.8	130.0	131.0	133.0	134.1	116.2	122.5	132.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	175.2	176.4	175.8	177.3	178.9	181.1	181.2	182.9	184.0	185.0	186.0	186.3	175.7	179.6	185.1

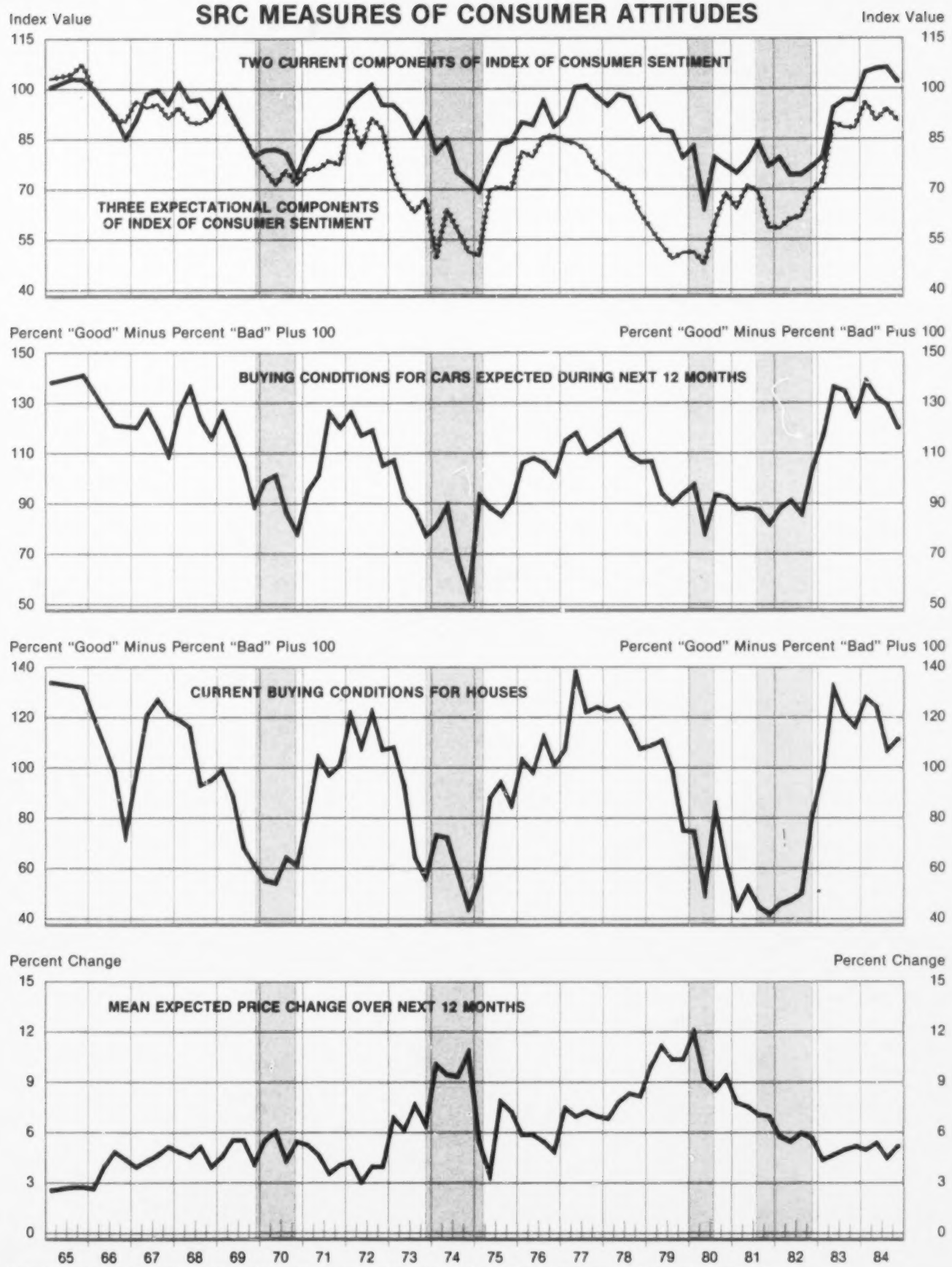
SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	82:1	82:2	82:3	82:4	83:1	83:2	83:3	83:4	84:1	84:2	84:3	84:4	1982	1983	1984
GROSS NATIONAL PRODUCT	3,026	3,061	3,080	3,110	3,174	3,267	3,347	3,432	3,553	3,645	3,695	3,764	3,069	3,305	3,664
PERSONAL CONSUMPTION EXPENDITURES	1,931	1,961	2,001	2,046	2,070	2,142	2,181	2,230	2,277	2,333	2,361	2,397	1,985	2,156	2,342
GROSS PRIVATE DOMESTIC INVESTMENT	436.2	431.2	415.9	376.2	405.0	449.6	491.9	540.0	623.8	627.0	662.8	634.3	414.9	471.6	637.0
NET EXPORTS	27.7	35.5	6.6	6.3	19.6	−6.5	−16.4	−29.8	−51.5	−58.7	−90.6	−49.2	19.0	−8.3	−62.5
GOVERNMENT PURCHASES	630.9	633.7	656.3	681.0	678.8	682.2	689.8	691.4	704.4	743.7	761.0	781.7	650.5	685.5	747.7
DISPOSABLE PERSONAL INCOME	2,132	2,157	2,195	2,238	2,261	2,303	2,367	2,429	2,502	2,554	2,606	2,648	2,181	2,340	2,578
PERSONAL SAVING RATE (% of disposable income)	6.7	6.3	6.1	5.8	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.3	6.2	5.0	6.1

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late February, and projected data, released by ASA-NBER in December, are displayed for fourth quarter 1984.

Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

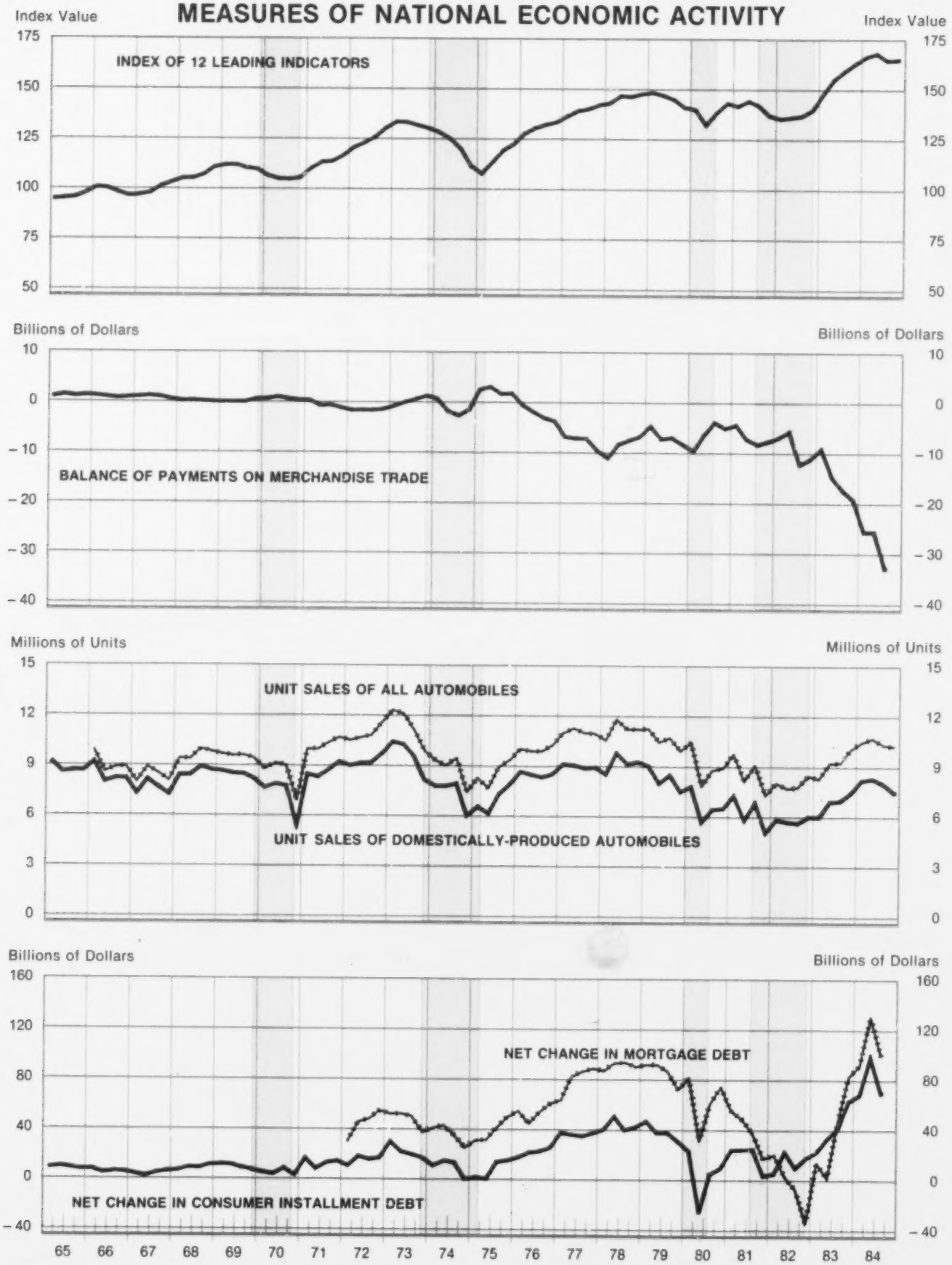
*Substantial revision of the data for variables marked with an asterisk has occurred since the last printing.

SRC MEASURES OF CONSUMER ATTITUDES



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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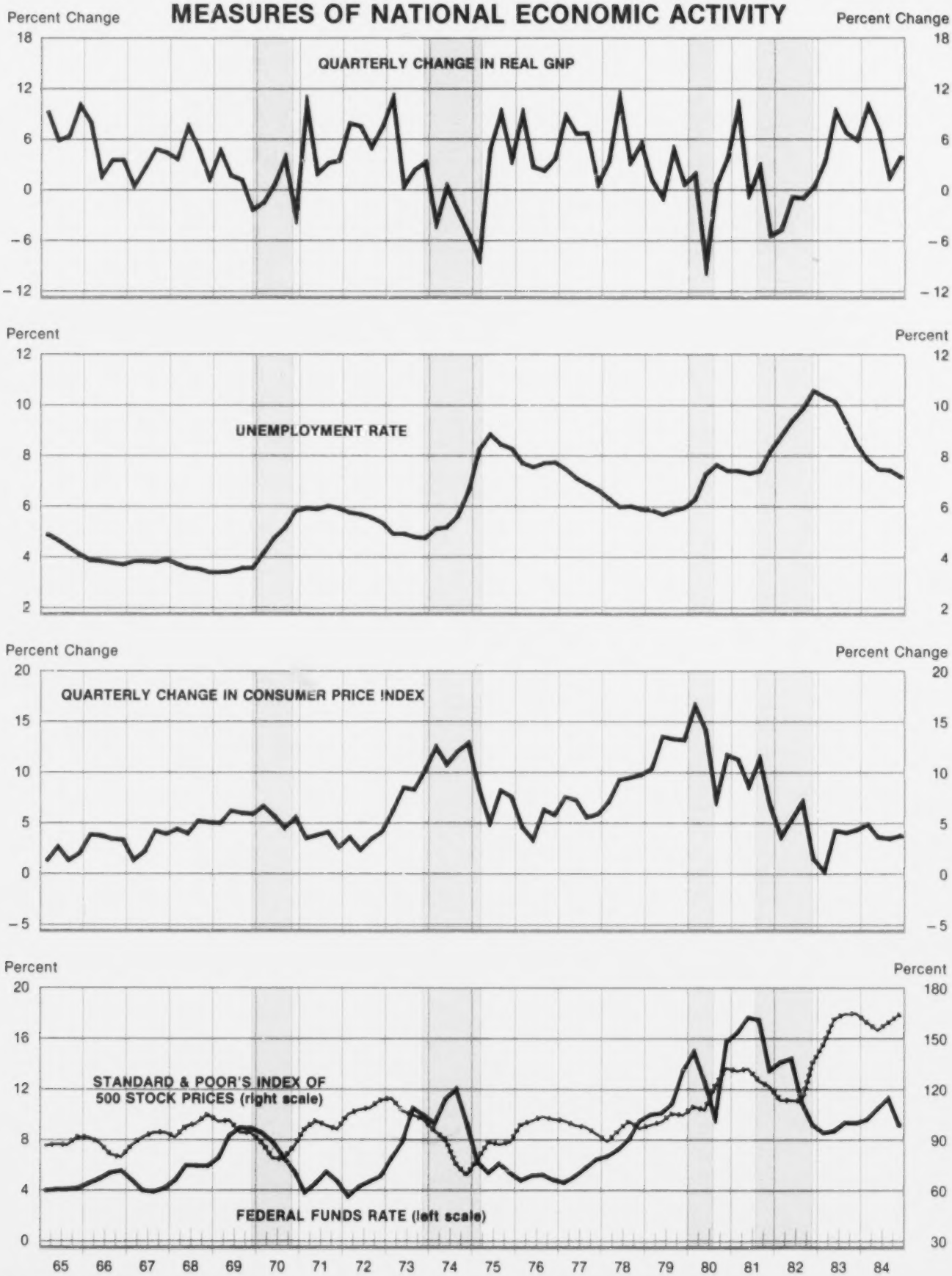
MEASURES OF NATIONAL ECONOMIC ACTIVITY



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F. Thomas Juster
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Richard T. Curtin
Consumer Optimism Maintained
Thornton and Freedman
The Changing American Family:
Living Arrangements and Relationships with Kin
Duane F. Alwin
Some Consequences of Recent Changes in
Household Composition

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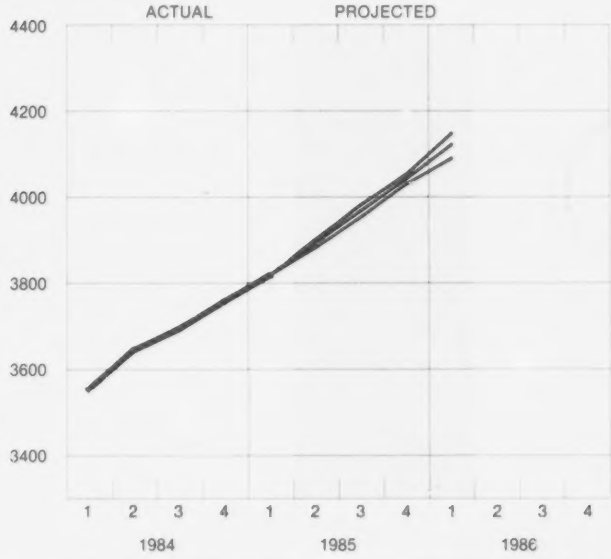
ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

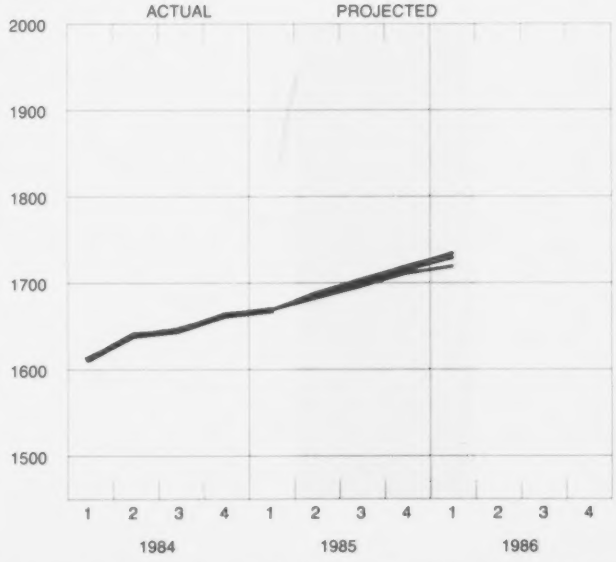
IN CURRENT DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



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The Unbalanced Recovery

F. Thomas Juster
Director, Institute for Social Research
and Professor of Economics
The University of Michigan

Introduction

Although developments in the macro economy are never seen uniformly by the macro economic forecasting fraternity, the incidence of surprises and of events that produce mixed signals seems to be higher than usual during the current expansion. The difficulties in producing reliable future scenarios of aggregate economic activity are well illustrated by events over the last several quarters. Toward the end of last year, when the expansion was just ending its second full year, it was widely thought that we could look forward to continued rates of growth of the order of four percent over the next several years. After a sluggish third quarter performance last year, the fourth quarter recovered to about the expected rate and most business observers expected 1985 to start off at about the same rate. But the flash report on first quarter GNP growth came in lower than expected, and the recently released first quarter data suggest that hardly any growth at all took place during that period. Thus real growth has averaged only a shade better than two percent over the last three quarters.

It is easy to make too much of short-term wiggles in the economy. And it may be that what appears now as a troublesome period of sluggish growth portending ill for the vigor of the expansion will turn out to have been a mirage when the major forthcoming revision of the National Income and Product Accounts is completed late this year. Still, one can find a number of elements in the composition of the present recovery that are unlikely to be changed by any revision of the data, and which represent elements that have rarely been found during past recoveries.

The current recovery is clearly unbalanced relative to normal behavior in a number of significant respects, and that unbalance is likely to be one of the reasons why forecasters have so much difficulty in tracking current developments. More importantly, the unbalanced nature of the recovery has some characteristics that create uneasiness about longer-term developments in the economy and in the society at large.

The characteristics of this recovery that differ from the typical postwar recovery in the U.S. economy are (1) the difference in growth rates between domestic demand and domestic production, (2) the difference between growth in goods-producing industries and growth in services, and (3) the difference between income growth for the upper and lower halves of the income distribution. All of these differences are presumably a reflection of the U.S. policy mix during the last several years—very loose fiscal policy that continues to produce Federal government deficits of the order of $200 billion, coupled with monetary policy designed to restrain the growth of nominal GNP, and hopefully inflation, to moderate levels—a policy mix which is generally agreed to have resulted in high real interest rates, a strong dollar, and a weakened U.S. competitive position in foreign markets.

Domestic Production and Domestic Demand

The difference between domestic production and demand is easily illustrated by a few macro numbers. From the fourth quarter of 1982, when the current recovery began, to the first quarter of 1985 (a 10-quarter span), GNP in 1972 prices grew by roughly $191 billion, or about 13 percent. Of the major components of GNP, consumption (again in 1972 prices) grew by $124 billion, investment by $102 billion, and government spending by $18 billion. That adds up to $244 billion, a bit over $50 billion more than GNP growth. The difference, of course, was in the negative growth of net exports, which fell from a plus $26 billion contribution in the third quarter of 1982 to a minus $26 billion contribution in the first quarter of 1985 (1972 prices). Exports actually declined over the period, while imports grew by almost $50 billion.

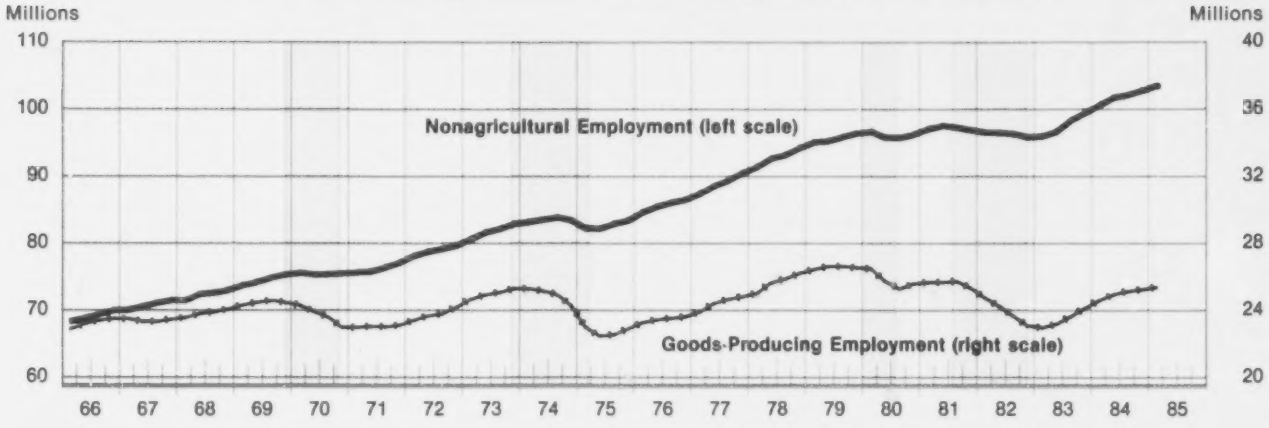
Thus domestic demand, which includes imports, grew at a 6.2 percent annual rate over this 10-quarter span, while domestic production, which includes exports, grew at a 4.8 percent annual rate over the same period. Although the growth rate of domestic production was healthy enough, it would have been almost a third higher if the trade balance had remained neutral. The point is not that domestic policy should be aimed at producing export surpluses, or that import surpluses are always undesirable, but rather that the apparent contradiction between strong domestic demand and much less strong domestic production is no contradiction at all once the massive shift in the trade balance is taken into account.

Goods and Services

Employment growth during this recovery shows a pattern which clearly reflects the trade picture. Total employment growth during the recovery has been substantial—from about 95 million total (civilian) nonagricultural employment at the end of the recession in late 1982 to a bit less than 104 million currently (see the chart below). The growth rate is about in line with employment growth during past periods of economic recovery: for example, total employment grew from roughly 82 million at the trough of the 1975 recession to about 96 million at the peak of the expansion in early 1980—an increase of roughly 14 million over about five years, while employment grew from roughly 75 million at the beginning of the 1971 expansion to about 83 million at the peak three years later. In all past periods of expansion, total employment has quickly outstripped the peaks reached during the previous expansion, usually within a year after the expansion began and sometimes almost immediately. The current recovery looks much like past recoveries in that regard.

But the picture is quite different if one looks at nonagricultural employment in goods-producing industries. Here, the total gain has been slightly over 2 million—from a little under 23 million to a current total of a bit over 25

Civilian Employment in the Nonagricultural Sector and in Goods-Producing Industries (Quarterly Data, 1966:1-1985:1)



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

million. But in contrast to all past periods of expansion, the total has not yet reached the 1979 peak of roughly 26.5 million persons employed, and it has actually not even returned to the level reached during the abortive expansion of 1980-81, where the total got to be around 25.7 million. During all past expansions (with the exception of the brief 12-month expansion of 1980-81) nonagricultural employment in goods-producing industries has always outstripped previous peaks, although usually not until the expansion was several years old. But in this expansion, goods-producing employment is well below past peaks, and the recent trajectory of change suggests that it may be difficult to reach the previous peak level during this expansion.

Again, appropriate national policy does not necessarily mean that employment in goods-producing industries in the U.S. should continue to grow, always reaching peak levels higher than those obtained during past expansion periods. But the growing competitive disadvantage of American workers in tradable commodities is visibly manifested by these macro totals, and the picture would look even worse if employment in defense-related, goods-producing industries were subtracted from the goods-producing total—employment in defense areas must have been growing rapidly in recent years, given the build-up in defense hardware.

As with the increasingly adverse trade balance on current account, there is nothing sacrosanct about the need for a growing goods-producing sector in the U.S. economy, as opposed to, let us say, the advantages of a vigorous and rapidly growing services sector. But there may well be an issue here involving short-term advantages and long-term costs. Assume that sluggish growth in the goods-producing industries in the U.S. is partly the consequence of a temporarily over-valued dollar. Even in that case, real U.S. investments in those industries are likely to be inhibited, foreign investments encouraged. The current decline in the U.S. share of goods output may thus result in some permanent loss of market share, even if long-run considerations of economic efficiency would argue for a larger U.S. goods-producing sector and share of world output. In effect, the loss of market share would not entirely be a consequence of economic efficiency considerations, but is simply part of the fallout from the high-deficit/high-real-interest-rate policy stance of the administration.

Income Distribution

A quite different measure of imbalance in the recovery is the apparent effect of income distribution policies, and of the recovery itself, on the distribution of earnings and income. Economic recoveries tend to be relatively neutral insofar as income distribution is concerned. Job opportunities expand rapidly during economic expansions, and many people in the low or middle parts of the income distribution tend to show rapid earnings increases because they reacquire jobs or work more hours. Because profits and eventually dividends show greater than average growth during economic expansions, many people at the upper end of the income distribution also show substantial income gains.

While both employment and hours growth and the growth of profits and dividends have characterized this expansion along with all previous ones, there are some special features of the current expansion that are unusual, if not unique. During this recovery, it appears to be true that there have been growing rather than declining absolute numbers of Americans falling below the poverty line. Analyses based on annual CPS data, for example, show that the poverty population increased slightly in 1983 (the most current data available), despite the strong recovery during that year. No previous expansion shows that result. At the same time, the overall distribution of income in the U.S. appears to have moved slightly toward greater inequality—the fraction of income received by the top fifth of the income distribution has grown during the expansion, while the fraction received by the bottom fifth has declined somewhat.

While the effects of social policies are difficult to isolate in macro distributions of this sort, it seems probable that the combination of differential reductions in personal income tax rates, cuts in social programs that mainly affect the lower part of the income distribution, and high real rates of interest are responsible for both the growth in numbers of people below the poverty line and the apparent increase in income inequality.

Prospects for Sustained Expansion

Do any of these imbalances threaten the vigor of the recovery? As a short-run proposition, the answer is probably

no: although the domestic recovery in output and employment would be more vigorous if the trade balance shifted in favor of fewer imports and more exports with the same level of domestic demand, it is certainly possible to sustain an expansion with sufficiently strong domestic demand to keep pushing up domestic production at reasonably satisfactory rates. The fact that relatively more of domestic production consists of services, and relatively less of goods, does not in itself threaten the recovery. And there is no evidence that the shift in the income distribution, and the rising numbers below the poverty line, have much impact on the demand for consumption in a macro sense, or on the rate of personal saving, or on other macroeconomic variables of interest.

Nonetheless, the prospects of sustained recovery are viewed with some skepticism by a sizeable number of macroeconomic forecasters. For example, most members of the National Association of Business Economists—largely a group of corporate forecasters—expect a recession in 1986. Data from the National Association of Purchasing Management have been signaling prospective weakness for some time. And simply scanning the recent behavior of a variety of macro time series is disquieting. For example:

- The composite index of leading economic indicators has been flat for about a year, and actually peaked in May of 1984.
- The ratio of coinciding to lagging indicators—historically one of the more reliable predictors of economic weakness—has been declining sharply since January 1984.
- Most labor market indicators are showing weakness rather than strength—unemployment has stopped falling, average hours in manufacturing peaked early last year, weekly unemployment insurance claims have been rising for over a year, etc.
- Industrial production has been flat since the middle of last year.

On the other hand, virtually all of the macroeconomic models are predicting sustained expansion for the next several years, although typically at low to moderate rates in the 3-4 percent zone. Why the difference in the behavior of many indicator series and the macro models? It's hard to say; one possible reason is that the macro models are typically much better at tracking demand (which has been relatively strong during this expansion) while the indicator series noted above are more concerned with tracking production (which as noted has been weaker than demand).

Policy Alternatives

What can be said about the role of policy in sustaining the expansion? The current debate about the budget is clearly predicated on the notion that a change in the mix of fiscal and monetary policy is essential to continued growth. Everyone seems to agree that the deficit has to be reduced in order to provide some leeway for monetary policy to allow interest rates to fall. Just how to reduce the deficit is a subject of considerable dispute. The president wants to cut or eliminate social programs and continue vigorous growth in defense, the Congressional Democrats want to stabilize defense and trim social programs only slightly, and the Congressional Republicans are in the middle—more defense cuts than the president wants, and more social program cuts than the Democrats want.

Interestingly enough, no one wants to raise taxes as part of the deficit reduction package, for a combination of ideological and political reasons. Everyone seems to agree that the Mondale campaign pledge early in the 1984 campaign—to raise taxes because that was essential for a sufficiently large deficit reduction package—cost a great many votes. That judgment may be correct or incorrect, but it is clear that no one will take the lead in suggesting tax increases, for fear that the political opposition will then proceed to bury them. And the president will clearly not take the lead here for ideological reasons—he seems to believe that raising taxes will threaten the recovery by cutting into incentives, despite the complete lack of any evidence to support that proposition.

The specter that lies behind at least some of the pressure to cut the structural deficit is almost certainly the unpleasant scenario of a recession that *starts off* with a structural deficit of some $200 billion. In that event, policy makers would face the Hobson's Choice of allowing the deficit to grow substantially as tax receipts declined and transfer payments rose, or cutting expenditures/raising taxes and thus making the recession deeper and longer. Of course, the way to avoid that choice was to have taken steps to correct the problem while the economy was recovering strongly, but that period is now behind us. It is still better to make the adjustment now rather than later, and one can hope that the political process will produce an acceptable compromise. If it doesn't, the same imbalance problems will be with us next year, except that the solutions will be harder to find rather than easier.

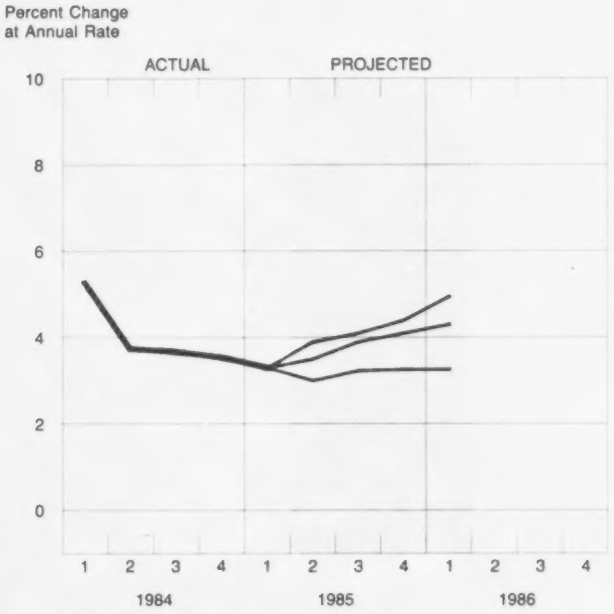
Finally, what about tax reform? The president's proposal is advertised as revenue-neutral, as creating a greatly simplified reporting requirement, as enhancing equity, and as promoting incentives to work, save, and invest. Revenue neutrality is probably a desirable feature of any tax reform proposal—one wants the reform to be considered on its own merits, not in conjunction with discussion and debate about whether taxes should generally be higher or lower. Simplification is always better than complexity, although it is far from clear to this writer why the central features of the reform—tax rate cuts, three rates instead of eleven, elimination of some deductions for itemizers, and increases in the standard deduction—make reporting any simpler for the taxpayer. Most of the complexity of the tax system results from the need to define and report taxable income, not from the need to calculate taxes once taxable income has been computed. While the proposal may be an improvement here, the improvement is likely to be modest for most people.

The proposal's main areas of interest lie in what it does for equity and what it does to incentives. Perceived fairness is an important aspect of any tax system, since fairness has an important influence on compliance. Whether any new system will be seen as more equitable probably cannot be determined until taxpayers have used it for a few years, although on the surface the proposal looks to be a significant improvement over present law.

On the incentives issue, the proposal promises a lot but is unlikely to deliver much. The fact of the matter is that there is simply no credible evidence that tax reform will do anything measurable to incentives to work, save, or invest. It will of course affect such macro variables because it will change cash flows of one kind or another—positively for some households and businesses, negatively for others—

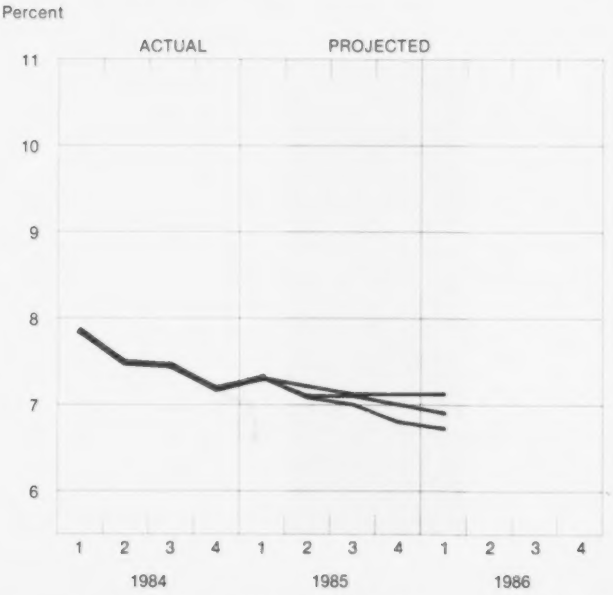
but aside from such direct impacts, the chances of anything interesting happening to the saving rate, the labor force participation rate, marginal decisions to work more or fewer hours, or real investment decisions are not very great. Thus tax reform is unlikely to solve any of our current macro policy problems, and one of the risks is that action on those problems will be deferred because people will think that tax reform *is* a solution.

CONSUMER PRICE INDEX



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Consumer Optimism Maintained

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Extended Recovery

In the first quarter 1985 survey, the Index of Consumer Sentiment was 94.5, about the same as the 95.0 recorded in the fourth quarter of 1984, and only 5 points below the cyclical peak of 99.5 recorded in the first quarter of 1984 (see the chart below). In each of the past eight quarterly surveys, the Index of Consumer Sentiment has remained in the relatively narrow range of 91.5 to 99.5, with the most recent reading just below the two-year average of 94.9. This represents the most favorable two-year period since the mid-1960s.

Over the past five years, the Index has not only posted a larger net increase than that following any of the recessions of the 1970s, but the Index has also remained near peak levels for an unusually extended period of time. During the prior five-year period, from 1975 to 1980, the Index rose from the 1975 recession lowpoint to a cyclical peak in 1977, and subsequently fell to the 1980 recession lowpoint. In a similar fashion, the period from 1970 to 1975 included one complete cycle from recession lowpoint, through recovery and expansion, to the next recession lowpoint.

Price and Interest Rate Discounts Attract Buyers

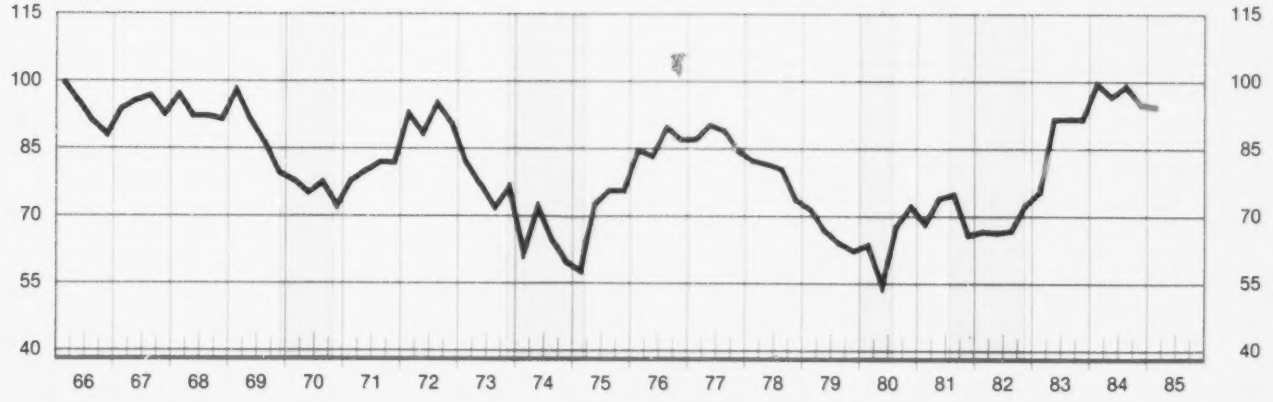
Attitudes toward buying conditions improved in the first quarter 1985 survey and reestablished the record favorable levels recorded two years earlier. It was in the spring of 1983 that attitudes toward buying conditions first reached record favorable levels. Following small declines during the balance of 1983, attitudes toward buying conditions rebounded to peak levels by the spring of 1984. Small declines were again recorded in buying attitudes during the second half of 1984, only to again rebound to peak levels in early 1985. The major reason for the pattern of spring resurgences followed by declines later in the year has been changes in the availability of discounted prices and reduced interest rates.

The first quarter 1985 survey recorded the highest proportion of American families in more than thirty years to hold favorable attitudes toward buying conditions for large household durables. Favorable buying attitudes were held by 74 percent of all families in the first quarter 1985 survey, up from 68 percent one quarter earlier, and above the 71 percent recorded at the start of 1984. The maintenance of buying attitudes at record levels for more than a year has been due to favorable perceptions of market prices for large household durables. The availability of discounted prices was reported by 41 percent of all families in the first quarter 1985 survey, the highest level ever recorded. These reports of price discounts rose from 30 percent at year-end 1984, and were just above the 40 percent recorded in the first quarter of 1984—the prior peak.

Favorable attitudes toward buying conditions for vehicles were held by 63 percent of all families in the first quarter 1985 survey, up from 59 percent in the fourth quarter of 1984, and just below the 64 percent recorded one year earlier. The availability of discounted vehicle prices was mentioned by 27 percent of all families in the first quarter 1985 survey, up from 18 percent one quarter earlier and 24 percent one year earlier. In addition to more favorable perceptions of vehicle prices, the availability of lower interest rates on vehicle loans has also attracted buyers. References to the availability of lower interest rates on vehicle loans were made by 23 percent of all families in the first quarter 1985 survey, up from 16 percent one quarter earlier, while complaints about high interest rates fell to 7 percent from 10 percent one quarter earlier. The recent quarterly increase in

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

references to lower interest rates was especially strong among households with above-median income (rising to 30 from 19 percent).

Favorable attitudes toward buying conditions for homes were held by 62 percent of all families in the first quarter 1985 survey, up from 53 percent one quarter earlier, and just above the 61 percent recorded one year earlier. This recent improvement nearly reestablishes the cyclical peak of 64 percent recorded in the spring of 1983. The major factor behind the revival has been recent declines in interest rates. The availability of lower mortgage interest rates was mentioned by 41 percent of all families in the first quarter 1985 survey, up from 30 percent one quarter earlier and 36 percent one year earlier. This increase in reports of lower mortgage rates was concentrated among households with above-median income, rising to 60 from 47 percent. Complaints about high mortgage rates were made by 25 percent of all families in the first quarter survey, down from 38 percent six months earlier, and just above the 23 percent recorded one year earlier.

Interest rate expectations improved substantially over the mid-1984 level, offsetting the entire deterioration recorded last year. Among all families in the first quarter 1985 survey, 39 percent expected interest rate increases during the year ahead, down from 55 percent recorded six months earlier, and just below the 40 percent recorded one year earlier. Declines in interest rates were expected by 24 percent of all families in the first quarter survey, up from 17 percent one year earlier.

Personal Financial Progress Slows

The pace of improvement in the financial situation of American families slowed by the start of 1985, but nonetheless remained very favorable. Among all families in the first quarter 1985 survey, 41 percent reported that their financial situation had improved during the past year, just below the 44 percent recorded one quarter earlier and the 45 percent recorded one year earlier. Financial reversals during the past year were reported by 26 percent of all families in the first quarter 1985 survey, unchanged from one quarter earlier, and just above the 25 percent recorded one year earlier. Among families with incomes of $20,000 or more, the first quarter 1985 survey marked the fifth consecutive quarter in which a majority (54 percent) reported an annual improvement in their financial situation. The maintenance of these improved financial evaluations was due to favorable income trends during the past year, as well as the continued low rates of inflation. Among all families in the first quarter 1985 survey, 33 percent reported that their income had increased during the past year, just below the 35 percent recorded in both the quarter- and year-earlier surveys. Declines in family income were reported by 16 percent of all families in the first quarter survey, just below the 17 percent recorded both one quarter and one year earlier. Reports of overall increases in income have outnumbered reports of overall declines by a margin of two-to-one among all families (three-to-one among high income families) for more than a year.

Compared with opinion at the start of 1984, fewer families at the start of 1985 expected their financial situation to improve during the year ahead. Nonetheless, few families expected actual financial reversals at the start of either year, with improvement nearly three times more frequently expected. The majority of families expected their financial situation to remain the same on balance during the year ahead. Given the favorable financial progress reported by families during the past year, this expected maintenance of their improved financial situation represents a favorable outlook. Among all families in the first quarter 1985 survey, 35 percent expected their financial situation to improve, down from 38 percent in the fourth quarter of 1984 and 41 percent in the first quarter of 1984. Financial reversals during the year ahead were expected by just 12 percent of all families in the first quarter of 1985, just above the 11 percent recorded one quarter earlier and the 10 percent recorded one year earlier. Income increases were expected by 56 percent of all families in the first quarter 1985 survey, down from 64 percent one year earlier. During the past year, the proportion of families that expected their nominal income to remain unchanged rose slightly, from 25 to 27 percent, while expected declines in family income rose from 9 to 16 percent.

Tax Simplification

In the January and February 1985 surveys, respondents were asked whether they expected Congress to adopt reforms in the personal income tax codes, so as to lower tax rates and eliminate deductions. Among all families, 42 percent expected passage of this tax reform legislation, compared with 48 percent that did not expect passage. Respondents were also asked whether they expected to be personally better or worse off financially if Congress did enact this type of tax reform. The majority of families (56 percent) expected this simplification in the tax law to have no net effect on their financial situation (Table 1). An improved personal financial situation as a result of the tax reform was expected by 20 percent of all families, just above the 18 percent that expected a worsened financial situation. Interestingly,

TABLE 1. Tax Simplification Proposal: Expectations about Passage and Impact on Personal Finances (First Quarter 1985)

Expectations	Percent
About Passage	
Will Pass	42
Won't Pass	48
Don't Know	6
Not Ascertained	4
Total	*100*
About Impact on Personal Finances	
Will Be Better Off	20
No Difference Expected	56
Will Be Worse Off	18
Don't Know	3
Not Ascertained	3
Total	*100*

The questions were: "Lately there has been a lot of talk about changing the way federal income taxes are figured for individual taxpayers, so as to eliminate deductions and lower tax rates. Do you expect Congress to make this type of change in the tax laws?" and "Do you think that you (and your family living there) will be better off or worse off financially if Congress makes this change in the tax laws, or won't it make much difference to your financial situation?" Number of cases was 1295.

TABLE 2. Relationship between Expected Passage and Expected Impact of Tax Simplification Proposal (First Quarter 1985; Entries in Percent)

Expected Impact on Personal Finances	Expectations about Passage	
	Will Pass[1]	Won't Pass[2]
Better off	22	22
Same; no difference	56	59
Worse off	20	17
Don't Know	2	2
Not Ascertained	*	*
Total	*100*	*100*

[1]Number of cases was 540. [2]Number of cases was 623.
*Less than 0.5 percent.

whether families expected passage or not, they anticipated approximately the same impact on their own financial situation (Table 2).

Slower Economic Growth Reduces Employment Prospects

The majority of families have favorably rated the annual progress made by the national economy in each quarterly survey for nearly two years. Among all families in the first quarter 1985 survey, 58 percent thought that the national economy had improved during the past year, down from 64 percent one quarter earlier, and below the cyclical peak of 71 percent recorded one year earlier.

Despite these favorable annual assessments, recognition of more recent favorable economic developments has waned—in part due to habituation to news of the ongoing expansion, and in part due to the slowing pace of economic growth. By the start of 1985, the mix of economic news reaching consumers was no longer dominated by favorable developments, for the first time in two years. In the first quarter 1985 survey, as many families reported that they had recently heard of unfavorable economic developments as reported hearing of favorable developments—43 percent. This stands in sharp contrast to the start of 1984, when more than twice as many families reported favorable as unfavorable developments (67 versus 30 percent). This shift in the mix of news heard and recalled by consumers has focused on changing job prospects. During the past year, references to news reports of increases in employment fell from 26 percent to 14 percent, while news of increases in unemployment rose to 19 from 12 percent.

Consumers expect a continued modest growth rate for the national economy during the year ahead, but nonetheless favorable economic conditions. Among all families in the first quarter 1985 survey, 30 percent expected the national economy to improve during the upcoming year, down from 41 percent one year earlier, and the all-time peak of 52 percent recorded nearly two years earlier. The expectation that the national economy would suffer overall reversals during the year ahead was not very widespread at the start of 1985 (15 percent). Rather than renewed declines, the majority of consumers in the recent survey (53 percent) expected the performance of the economy to remain similar to last year's.

Despite the slowdown in the rate of economic growth, the majority of families have for nearly two years expected good overall economic conditions. In the first quarter 1985 survey, 62 percent of all families expected good times financially in the economy as a whole, up from 59 percent one quarter earlier, although below the cyclical peak of 69 percent recorded one year earlier. Longer-term economic prospects also remained favorable at the start of 1985, although somewhat lower than at the 1984 cyclical peak (46 percent). At the start of 1985, 41 percent of all families expected good times financially in the national economy over the next five years, just below the 44 percent recorded at the start of 1984.

The outlook for slower but continued economic growth is based on the expectation of no further reductions in the unemployment rate, but continued low rates of inflation. Consumers expected the annual rate of inflation to average 4.4% in the first quarter 1985 survey, down from the 5.1% recorded both one quarter and one year earlier. Among all families that expected price increases, two-thirds expected an inflation rate of 5% or less during the upcoming year.

The proportion of families that expected declines in the unemployment rate reached its cyclical peak in the second quarter of 1983, and since then has steadily declined. By the start of 1985, 21 percent of all families expected unemployment to decline during the year ahead, down from 35 percent one year earlier, and the 1983 cyclical peak of 40 percent. Increases in unemployment were expected by 27 percent of all families in the first quarter 1985 survey, up from 15 percent one and two years earlier. Importantly, the majority of consumers in each of the past four quarterly surveys expected the unemployment rate to remain at about its current level during the year ahead. Confidence in government economic policies to control inflation and unemployment remained at very favorable levels at the start of 1985.

Summary

The maintenance of consumer sentiment at near record favorable levels points toward continued high levels of sales throughout 1985. The widespread availability of discounted prices and interest rates have restored buying attitudes to the cyclical peak levels recorded one and two years earlier. Personal financial progress has slowed, but the financial situation of families remains strong. Although the economic slowdown is expected to persist during the year ahead, no recession is expected. Trends in interest rates on consumer loans will continue to influence the evolving pace of demand, and less favorable job prospects are viewed by consumers as the primary source of future adversity.

If the economy has now entered an extended period of slow growth, it is unlikely that the evolving pace of growth will be smooth during the upcoming year. Monthly variations in the pace of growth will seem relatively large compared with the anticipated annual average; and monthly variations will more often seem to indicate the emergence of a recession, since the growth rate in any given month may slip below zero when the annual average hovers at so low a level. This implies that trends in consumer spending during the year ahead may be dominated to greater extent by variations about this slower pace rather than by mounting and sustained overall declines.

May 1985

The Changing American Family: Living Arrangements and Relationships with Kin

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HOUSEHOLD STRUCTURE AND LIVING ARRANGEMENTS

Historically, most American households have been predominantly nuclear, containing only one married couple. Although it was not uncommon for a young married couple to live with parents early in marriage and for an older couple to live with a married child, joint families, with more than one married couple from the same generation sharing the same household, were rare. Nevertheless, American households were often complex; a conjugal family of parents and their minor children frequently shared their living facilities with additional persons—both relatives and others. Widowed parents often lived with their married children. In early America, many young persons both lived and worked in the households of relatives or others. Later, in the 19th century, many young persons still were to be found living with other families, but usually just as boarders or lodgers.

Over the years, American households have changed in several important ways. Households have become smaller and less complex, and there has been an increasing trend toward independent living among young unmarried persons, the elderly, and mothers with no current spouse.

Household Size

The size of American households has declined almost uninterruptedly since the first census was taken in 1790. As shown in Table 1, average household size in 1980 (2.75 persons) was less than half the average of 1790 (5.79) and over 40 percent less than in 1900 (4.76). Prior to 1900, the decline in household size was primarily due to the replacement of very large households of six or more individuals with households of two to four persons. From 1900 to 1950, the biggest change was the decline in households with five or more persons and the increase in two-person households. One-person households, previously a rarity, made their first substantial gain during this period. Since 1950, the predominant trends have been a large gain in single-person households, to 23 percent of the total in 1980, and a drop in households with more than two members.

An important element in the reduction in household size prior to World War II was the decline in fertility. Couples raised fewer children and were younger at the birth of their last child. With fewer children, the relative number of large households declined steadily and substantially. Since parents also reached the "empty nest" stage earlier and enjoyed greater longevity, they experienced a longer period with no children at home. Elderly married couples without adult children in their homes also became more prevalent as young adults established their own households earlier. Although data deficiencies prevent precise comparisons, Table 2 suggests that this change has been substantial; the percentage of married couples over age 65 with unmarried children in the home declined from more than 40 percent in 1900 to about 15 percent in 1962, and was only 10 percent in 1975.

Another important change in living arrangements is the virtual disappearance of the practice of living in a household as a boarder, lodger, servant, or employee. In the last half of the 19th century, when the country was urbanizing rapidly and housing was scarce, as many as 15 to 20 percent of urban households included lodgers, many of whom were young persons making the transition to adulthood. At present, less than 5 percent of households contain boarders.

Editor's Note: This is the final article excerpted from the authors' "The Changing American Family," *Population Bulletin*, Vol. 38, No. 4 (Population Reference Bureau, Inc.: Washington, D.C., 1983). It is published here with the kind permission of the Population Reference Bureau, Inc. The first article, concerning marriage and divorce, appeared in the Spring 1984 issue (11:2), the second, concerning childbearing, appeared in the Autumn 1984 issue (11:4). Complete references for the material cited herein are contained in the *Population Bulletin* monograph.

TABLE 1. Household Size: 1790-1980
(Percentage distribution of households by number of persons)

Number of Persons	1790	1900	1930	1940	1950	1960	1970	1980
Total	100	100	100	100	100	100	100	100
One	4	5	8	7	11	13	17	23
Two	8	15	23	25	29	28	29	31
Three	11	18	21	22	22	19	17	17
Four	14	17	18	18	18	18	16	15
Five	14	14	12	12	10	11	10	8
Six or More	49	31	18	16	10	11	11	6
Average Persons per Household	5.79	4.76	4.11	3.67	3.37	3.33	3.14	2.75

TABLE 2. Living Arrangements of Married and Unmarried Persons Aged 65 and Over: 1900, 1962, 1975
(Numbers in percent)

Living Arrangements	Married			Unmarried		
	1900	1962	1975	1900	1962	1975
Total	100	100	100	100	100	100
Alone or with Spouse Only	29	79	84	11	48	67
With Married Child	16	2	1	38	14	7
With Unmarried Child	42	15	10	27	20	10
With Other Relatives	7	3	5	13	12	13
With Nonrelatives	6	1	0	11	6	3

Note: Because data collection procedures used in 1900 differed from those of 1962 and 1975, it is possible only to make general comparisons between 1900 and the other two years.

Independent Living

Since 1950, most of the decline in household size has been due to a dramatic trend toward "independent" living. Just between 1970 and 1983, the number of new American households grew 33 percent – from 63 to 84 million – while the total population grew only 14 percent in these 13 years. In record numbers, young people were leaving the parental nest after school and before marriage to set up their own households, alone or with friends of their own or the opposite sex; retirees chose to live on in their old homes or move to a new apartment or a retirement community rather than move in with children; spouses moving out after a divorce (usually the husband) opted to set up their own households rather than join others; and never-married, separated, or divorced mothers also chose to keep or set up separate households for themselves and their children.

One type of independent living is now virtually universal – newly married couples immediately setting up their own households rather than living for a time in a parental household, which was still not uncommon in 1950. By 1978, only 2 percent of married couples with the husband aged 25-34 did not maintain an independent household, down from 10 percent in 1950.

Table 3 illustrates young American adults' dramatic shift to independent living before marriage. Between 1950 and 1982, the percentage of never-married people aged 25-34 maintaining their own households more than quadrupled for both men (9.5 to 42.7 percent) and women (11.0 to 53.3 percent). For men, a shift to living alone or with unrelated persons accounted for all the increase. For women, the increase included a fivefold increase in the percentage of never-married women heading a family household – a reflection of the increase in premarital childbearing, more single mothers rearing their own children, and their greater tendency to live apart from parents and other relatives. The figures in Table 3 actually understate the trend toward independent living among unmarried adults. The nonrelatives who share accommodation with an unmarried household head are usually themselves unmarried adults living apart from their parental families.

The Elderly

Although elderly married couples in America usually have lived in their own homes apart from their married children, Table 2 shows that in 1900 about 16 percent of married couples 65 or older did share living quarters with a married child and his or her spouse. Such intergenerational living has virtually disappeared in this century.

Equally dramatic has been the shift in living arrangements of elderly unmarried persons. Rough comparisons between 1900 and 1975 (Table 2) suggest that in 1900 over one-third of such persons lived with a married child, but by 1975 only 7 percent did. The proportion of older unmarried Americans living alone has increased from about one in ten to two out of three. Most of these are elderly widows or divorced women who never remarried. They can expect to live alone for a long period, since women now outlive men by a wide margin.

TABLE 3. Never-Married Men and Women Aged 25-34 Maintaining Their Own Households: 1950, 1960, 1970, 1982
(Numbers in percent)

Living Arrangements	Men				Women			
	1950	1960	1970	1982	1950	1960	1970	1982
Total Maintaining Own Household	9.5	19.4	31.1	42.7	11.0	21.1	35.2	53.3
Living with Family Members	4.6	4.3	4.5	4.1	3.6	6.7	11.9	16.8
Living Alone or with Nonrelatives	4.9	15.1	26.6	38.6	7.4	14.4	23.3	36.5

Note: 1950, 1960, and 1970 data come from decennial censuses, while 1982 data are from the Census Bureau's Current Population Survey and are not strictly comparable.

Although the parent-child relationship is often stressed as the crucial family tie in American society, significant numbers of older Americans—13 percent of the unmarried and 5 percent of the married in 1975—live with siblings or other relatives. This type of living arrangement is particularly important for elderly people who never married and lack the kinship support of spouse or children.

Living arrangements of the elderly are more varied for blacks than for whites. Fewer black elderly couples live by themselves (62 percent as compared to 84 percent of elderly white couples in 1975), and many more live with children (23 versus 11 percent) or with other relatives (16 versus 4 percent). Similar racial differences exist for the unmarried elderly.

One reason for the decline in co-residence of the elderly and their married children is that today's elderly are those who had their children in the low-fertility years of the 1920s to the early 1940s and now have fewer children with whom they might live in old age than earlier generations did; about 20 percent of all persons over 65 in 1975 had no living children. The next generation of elderly—the parents of the larger baby boom families—will have more children available, as noted earlier, but it seems unlikely that many more than now will opt to move in with children.

Surveys of residential preferences indicate that most elderly who live alone prefer to maintain their independence so long as their health and financial circumstances permit, though most also want to live near their children. As they grow older and their health deteriorates, more of the elderly do live with children; in 1975, 19 percent of unmarried men and 31 percent of unmarried women over age 80 lived with a child.

Maintaining a separate household now is economically more feasible for many elderly Americans. Because of Social Security benefits that have outpaced the rise in real wages and better retirement pensions, the large majority of today's elderly do not depend on their children for financial support. In fact, a recent study revealed that, because most Social Security benefits are tax-exempt and elderly households average few persons, the elderly in 1980 actually had a higher per capita income after taxes ($6,300) than the general population ($6,000). Many of the elderly are poor, particularly women, but the proportion of elderly single women with incomes below the poverty level dropped from 72 to 32 percent between 1959 and 1980, while the proportion for elderly couples was 32 percent in 1959, and only 16 percent for all the noninstitutionalized elderly in 1980. This improved financial situation has occurred even though few of the elderly now have an income from a job; in 1950, 45 percent of men aged 65 or older were still in the labor force, but only 18 percent in 1980.

The elderly still depend on their families for much health care. In 1975, some 15 percent of the elderly were severely handicapped physically, and two-thirds of these were cared for at home, with most of the care provided by relatives. Only 5 percent of all elderly persons were in health institutions in 1975.

Although institutionalization of the elderly is sometimes viewed as abandonment of parents by their children, it is usually the solution of last resort. Most of the institutionalized are the very old with serious physical impairments requiring constant care. These needs often go beyond the capabilities of close family members, many of whom are themselves growing old. Only about one in ten of the institutionalized elderly still have a surviving spouse, and about half have surviving children. Among the general elderly population, 80 percent have surviving children, and four out of five men and one of every two women still have a spouse. Providing family care for the elderly will become still more difficult if substantial numbers of Americans have no children or only one.

Families Maintained by Women

With increased divorce and out-of-wedlock childbearing, lower rates of marriage, and single mothers' greater tendency to live on their own, households headed by women with children under 18 but no husband present have now become a prominent type of family living arrangement. In 1982, there were nearly 6 million such households, making up 19 percent of all American housholds with minor children—double the number in 1970 and triple the number in 1960.

This trend has inevitably increased the proportion of children who live for some of their childhood in a fatherless home. About a quarter of children who were six and under in 1970 lived for at least a year in a fatherless home by 1979. Eleven percent spent more than half these ten years in such families, and 5 percent lived with their mother only for all ten years. If the current prevalence of female-headed families persists, it is estimated that 40 to 50 percent of all children will live in a fatherless family for some time before they reach 18.

Black children are more likely than white children to live with their mother alone because of blacks' higher rates of marital dissolution and out-of-wedlock childbearing and lower rates of marriage and remarriage. Fifty-seven percent of black children, compared to 20 percent of white children, who were six and under in 1970 experienced family living without a father for some time in the 1970s. Nearly 20 percent of black children spent the entire decade in a family headed by the mother, and only a third lived continuously in a two-parent home.

Time and money constraints are the two main reasons for concern about the high incidence of female-headed families. Single parents have less time for parenting, although research has not shown that the quality of care provided by single parents falls short of that in two-parent families. Single mothers are often severely limited in the financial resources available for them and their children. Not surprisingly, single mothers report greater stress and strains in their lives than do most other people.

Although single mothers with minor children made up only 19 percent of all family households with children in 1982, they accounted for 55 percent of households with minor children whose reported 1981 income put them below the poverty level. About 44 percent of fatherless families with children under 18 and 61 percent of those with children under six were classified as poor; for husband-wife families the figures were 9 and 11 percent. The 1981 median income of female-headed families with children under age 18 ($9,200) was about one-third that of similar husband-wife families ($26,200).

Earning a living wage is difficult for a single mother, both because of the problem of arranging child care (which they share with all working mothers) and because they tend to be ill-prepared for the job market; many were housewives or part-time workers prior to a divorce, and others are young, never-married women with little education. As a result, impoverished single mothers find it difficult to climb out of poverty by their own efforts, and many remain below

the poverty level year after year, with the most likely escape being marriage. Although welfare payments for single mothers, Aid to Families with Dependent Children, have kept pace with the increase in female-headed households, evidence concerning whether the availability of welfare encourages unmarried women to have children or men to desert their families is inconclusive.

Extended Family Living

The trend toward nuclear family households and independent living obscures the importance of extended family living in the United States. While relatively few live in extended households during any particular year, many Americans find it convenient or necessary to live with relatives at some time during their lives. Though virtually all young couples now begin marriage in their own households, as noted, 19 percent of white couples and 43 percent of black couples reported in the early 1970s that they lived with other kin for some time during the first five years of marriage. Most lived in the homes of parents, but some took kin into their own homes. Extended family living also occurs during the initial adjustment to separation or divorce and when a person is old and in need of assistance.

For children, having a grandparent or another relative move in, or going to their home for a period, can be important when parents temporarily find it difficult to fulfill their responsibilities because of a death, serious illness, or a single mother's lack of time and financial resources. In 1975, 9 percent of elderly whites and 36 percent of elderly blacks reported that they had at some point had "substantial or primary responsibility" for grandchildren.

FAMILY RELATIONSHIPS BEYOND THE HOUSEHOLD

Although most Americans may share a household with only a few close family members or none at all, they do maintain contact with a substantial network of kin, often over considerable distances.

Throughout the nation's history, kin have become dispersed, beginning with the first immigrations from abroad and continuing with migratory flows within the country from east to west, south to north, from rural to urban areas, and now from Frostbelt to Sunbelt, and from cities to the far suburbs and countryside. Family relationships have always been important forces in these migrations. In earlier times, parents with their married children and grandchildren or groups of families often migrated together, and many moves to new areas were prompted because relatives were already there to help with relocation. But many others migrated alone or with only a small family core, and family ties became attenuated when contact depended on an erratic postal service or arduous travel over long distances. Even today, contact with dispersed family members involves considerable commitment, given the expense and difficulties of long-distance communication.

Although Americans continue to be highly mobile, studies have shown that most live close to at least some relatives and maintain contact with many through visits, frequent communication, and mutual assistance. One study of newborn white children and their families living in the Detroit metropolitan area in 1962 found that five-sixths of these children had at least one grandmother and the majority at least one married aunt or uncle living in the Detroit area, and nearly half had a grandparent or married aunt or uncle living in the same neighborhood. Only about one in eleven of the children lacked nearby close kin. Sixty percent of these families got together with relatives at least weekly, and only about 13 percent saw relatives less than once a month. Further, the large majority of the families received assistance from their relatives in the form of gifts, child care, help when sick, taking care of the house, financial advice, and loans. Almost half of the mothers, for example, had received help from one of the child's grandmothers following the birth of the child.

The close involvement of young children with grandparents noted in this study would have been less possible in earlier times when fewer people survived to enjoy grandchildren. Improved life expectancy has now made possible intergenerational relationships which frequently extend across four and even five generations.

A study conducted in Muncie, Indiana, in 1977 showed that a high percentage of the close relatives of the residents surveyed lived within 50 miles of the city, including 61 percent of their living parents, 49 percent of siblings, and 68 percent of grown children. Most of those with surviving parents saw them at least monthly, and almost half saw them weekly or more; siblings were visited about half as often. Additional contacts with relatives were made via letters and telephone, and the majority of Muncie residents also reported that they exchanged aid with relatives.

Most elderly Americans also have and interact with a fairly extensive network of kin, not only younger generations, as already indicated, but also siblings. A national study conducted in 1975 found that four-fifths of Americans aged 65 and over have surviving children, as noted earlier, about the same proportion have grandchildren, half have great grandchildren, and four-fifths have a surviving sibling. Only about 5 percent have no surviving children or siblings. In 1975, about half of the elderly with surviving children lived with a child or less than ten minutes away; another fourth lived no more than 30 minutes from a child. During the week prior to the interview, three-fourths of those with children saw a child, one-third with surviving siblings saw a brother or sister, and three out of ten saw a more distant relative. Seventy percent of the elderly with children reported providing assistance to them, and nearly as many received help from children. Many also reported a similar exchange of help between them and grandchildren and great grandchildren. The elderly with failing health consistently report that relatives are their chief source of help, and relatives continue to be the primary source of emotional and social support.

Undoubtedly, there are substantial numbers of Americans with few kin, others have many relatives with whom they do not interact, some relationships may be more negative than positive, and many relatives are unable, for whatever reasons, to provide support desired by family members. Nevertheless, the vast majority of Americans today clearly maintain active contact with a considerable number of relatives.

CHANGE AND CONTINUITY

Present-day American family patterns present a mosaic of change and continuity. Some current patterns of family life—the high incidence of divorce and independent living—are clearly different from the past. Other dimensions—age at first marriage—are now very similar to earlier patterns

despite substantial recent fluctuations. Some recent changes incorporate both new developments and a return to old patterns. For example, the influx of mothers into the paid labor force constitutes an important change in the roles of women, but the new economic involvement of women also represents a reinstitution, though in a new form, of the contribution women made to family production in earlier times.

Despite changes in family structure and relationships, most Americans still regard the family as central to their well-being and happiness. Given the central importance of the family, the magnitude of family change has had a powerful impact on human relationships and on the quality of the lives of many individuals. The new availability of divorce, of employment for women, and the chances for independent living have provided important opportunities for many persons; yet, they also have brought psychological, social, and economic problems.

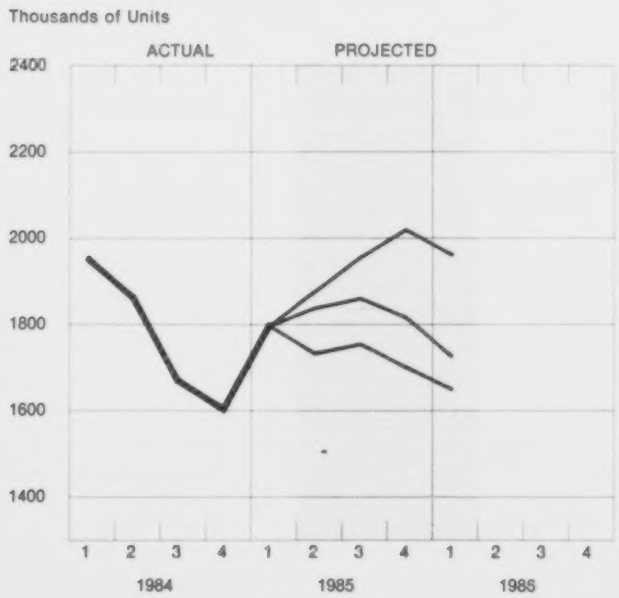
Explanations for the changes in American family life are difficult. Certainly the long-term trends in urbanization, industrialization, and economic growth have influenced family patterns, but many changes in the family have not shown clear and consistent relationships with these long-term trends. Major events, such as the Depression of the 1930s, World War II, and the Vietnam War also have had important and perhaps lasting influences on family life.

Predictions of future trends in family patterns are hazardous. Given the the scope of change, total reversal of recent patterns appears unlikely. We can probably expect that many people will marry only after a considerable period of living apart from their parents, either alone or with friends. Most wives will juggle home care and a job, with many taking little or no time out for childbearing and rearing. Most working wives will have only one or two children, and their preschool children will usually be cared for outside the home during their mothers' working hours. Many young children will experience the breakup of their parents' marriage and then will be likely to live with their mother only, though most will later acquire a stepfather and a readymade new family of "step-relatives." Most women can expect to live alone, though near their children and grandchildren, at the end of their lives; the few elderly men who lose a spouse are likely to remarry.

But this scenario could change, just as family patterns have fluctuated in the past. Having at least three children could become fashionable again, as in the baby boom. More delayed marriage could mean more compatibility among couples once they marry and thus less divorce. Parents could assume more of the care of their own children with flexible working hours that allow one of them to be at home when children are, or as the computer age shifts the workplace back to the home for many women and even men.

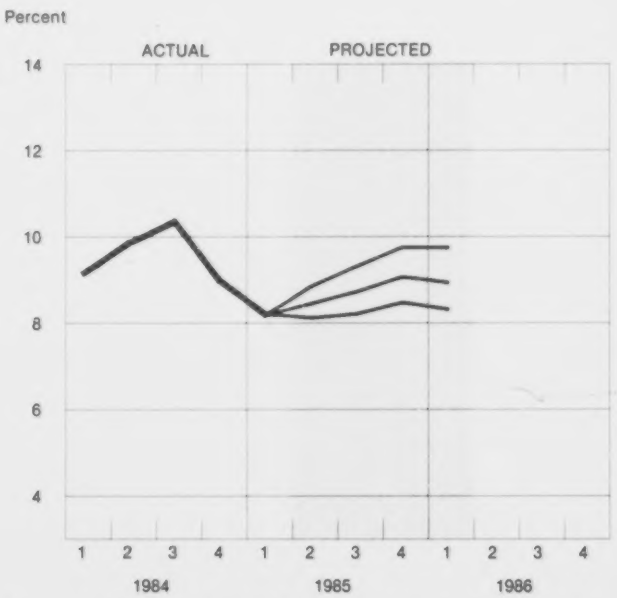
Although future changes in the family could actually bring more rather than fewer problems, the resilience of the family amidst the changes of the past demonstrates the ability of family life to adapt in a changing world. Families and family relationships continue to play a vital role in today's world and are likely to do so in the future.

NEW PRIVATE HOUSING UNITS STARTED



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

3-MONTH TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Some Consequences of Recent Changes in Household Composition[1]

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From the earliest available record the average size of the American household has been gradually declining.[2] Even within the past few decades household size has fallen rather dramatically, from slightly over 3 persons per household in 1970 to 2¾ persons in 1980. Whereas pre-1940 declines in household size were due primarily to declines in population fertility and mortality, more recent trends have been interpreted largely in terms of changes in living arrangements and residence norms. The major components of these changes in recent years involve the growth of non-traditional household types, particularly increases in the number of persons living alone and the number of households containing single parents and their children.

This paper briefly reviews the trends in household composition over the past several decades, discusses the major causes of these patterns, and examines some of their potential consequences for individuals. The information presented on trends in household composition since 1940 is based primarily on the U.S. Census Bureau's Current Population Surveys from tabulations of national survey information on households published in the *Current Population Reports*. Survey information presented on the individual concomitants of household living arrangements is based on the national Quality of Life Survey conducted by the Survey Research Center in 1978.

The Distribution of Living Arrangements

Although much has been written about the demise of the traditional family in the U.S., the most common type of living arrangement is the married-couple household. Although persons move in and out of marriages, at any time this represents the dominant form of living—about 60 percent of all households are of this type. Another 10 percent of households contain single parents living with their children. Nearly 25 percent of households now contain persons living alone, and the remaining 5 percent represents a variety of household types, including unrelated persons living together as roommates and those couples who are cohabiting.

Living arrangements are fundamentally linked to marital status and gender, and the Quality of Life (QoL) Survey can further illustrate how they are so linked.[3] For these purposes we consider four types of living arrangements: (a) persons living alone, completely by themselves with no other adults and/or children present; (b) persons living with children (aged 17 or younger) only; (c) persons living with other adults (aged 18 or more), but with no children; and (d) persons living with both adults and children. The first two categories are relatively unambiguous types of living arrangements, although the fact that children vary in age suggests that this category is far from homogenous. Owing to their greater heterogeniety, the latter two categories are somewhat less definite. Category (c), for example, contains married persons who have no children, persons who are cohabiting, and persons living with roommates. Similarly, category (d) represents a variety of different types, although the bulk of these are married persons with children.

In Table 1 the Quality of Life sample is cross-classified by living arrangements, marital status, and gender. The percentage figures in this table refer to the distribution of living arrangements within categories of marital status by gender. The figures in parentheses are the mean age for subcategories of the table.

As the table reveals, a high percentage of not-now-married persons live alone. Nearly 40 percent of never-married men and women, some 60 percent of divorced and separated men, and over 70 percent of the widowed are so situated. Divorced and separated women are about one-half as likely to be living alone as men in these marital categories, and the modal living arrangement for these women is that of living solely with children. Although not the dominant form, this is also a common situation of never-married women, nearly ten percent of whom are living alone with children. In sum, women were more likely to experience the circumstances of living alone or of living only with their children.

The figures in parentheses on average age in Table 1 reveal the covariation of living arrangements with age. For example, women are much more likely than men to live alone when they are older than when they are young. Indeed, the largest group among those persons living alone is women aged 45 and older. Although this is changing (see below), it occurs in part because women experience greater longevity and typically outlive their husbands. It is also due to the fact that never-married and divorced men living alone are younger than their female counterparts.

Trends in Living Arrangements

The patterns described in the above paragraphs are much different than those of preceding periods in U.S. history. In recent decades rather impressive changes have occurred

[1]This paper summarizes the results of research by the author, P. E. Converse, and S. S. Martin reported elsewhere: "Living Arrangements, Social Integration and Psychological Well-Being," paper presented at the annual meetings of the Midwest Sociological Association, Chicago, Illinois; and "Living Arrangements and Social Integration," *Journal of Marriage and the Family* (forthcoming). Complete references to other material pertaining to this topic are available from the author.

[2]See the previous article in this issue by Arland Thornton and Deborah Freedman.

[3]The Quality of Life data are based on a national probability sample (N = 3,692) of persons 18 years of age and older living in households (excluding those on military reservations) within the coterminous United States. Interviews were conducted during June through August 1978. The original sample of approximately 4,870 occupied housing units, comprising two independently chosen multistage area probability samples, was used to represent the noninstitutionalized adult population of the U.S. The overall completion rate was approximately 76 percent. This sample systematically underrepresents males and, to a slight degree, the widowed, divorced, and separated in this population.

TABLE 1. Distribution of Living Arrangements and Average Age by Marital Category and Gender: 1978 Quality of Life Sample

Living Arrangements	Marital Category					
	Never Married	Now Married	Separated	Divorced	Widowed	Total
			Males			
Alone	37% (34.2)	.5% (58.2)	57% (46.8)	66% (46.6)	72% (72.0)	18% (46.7)
Children	0% (–)	.5% (19.5)	14% (36.7)	10% (38.1)	7% (58.0)	2% (38.8)
Adults	42% (25.1)	47% (55.5)	25% (41.8)	17% (41.2)	12% (72.2)	42% (49.1)
Both	21% (20.7)	52% (38.0)	5% (49.0)	8% (41.3)	9% (60.0)	39% (36.5)
Total	100% (27.6)	100% (46.3)	100% (44.2)	100% (44.5)	100% (70.0)	100% (43.5)
n	298	1017	44	112	69	1540
			Females			
Alone	37% (41.7)	.5% (63.4)	26% (44.5)	35% (54.9)	76% (69.9)	23% (60.3)
Children	9% (26.1)	.5% (51.8)	44% (33.3)	45% (35.0)	8% (47.8)	9% (35.7)
Adults	30% (30.1)	47% (51.1)	12% (46.7)	10% (44.0)	13% (67.2)	34% (49.4)
Both	24% (21.5)	52% (35.0)	17% (35.5)	10% (43.2)	3% (55.0)	34% (34.3)
Total	100% (32.0)	100% (42.7)	100% (38.2)	100% (43.7)	100% (67.4)	100% (45.4)
n	280	1191	99	203	373	2146

Note: Average age of persons in the sub-category is in parentheses.

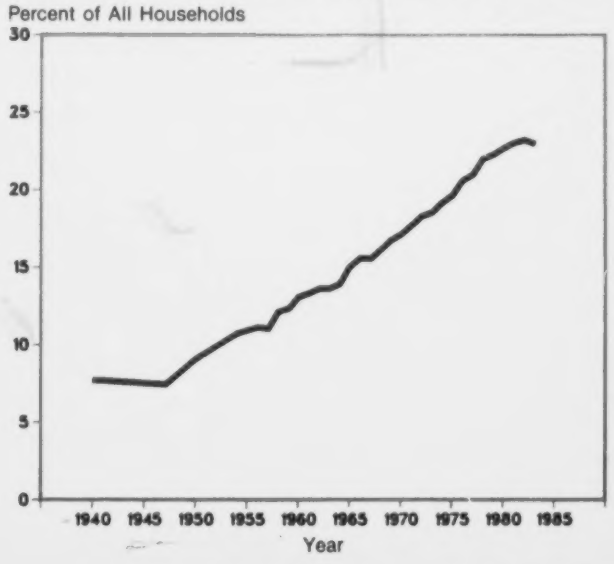
in several aspects of household composition due in part to changing family arrangements and modern lifestyles. Here I discuss two areas in which changes in the household have been the most dramatic, and which have implications for social isolation and quality of life: living alone and being a single parent.[4]

Living Alone. As seen in Chart 1, in 1940 slightly less than 8 percent of all households were occupied by persons living alone, while four decades later as many as 23 percent of all households contained persons living by themselves. This reflects major social change because in past years adults in the U.S. have lived primarily with other adults, rather than by themselves.

One component of this trend is the increased tendency for young persons to live alone. Census data indicate that increasing numbers of young persons are delaying marriage and establishing households away from their parents. While the population grew some 11.4 percent from 1970 to 1980,

[4]A third major type of living arrangement undergoing dramatic change is the number of unmarried persons living with a member of the opposite sex. Since this arrangement of living does not have implications of social isolation characteristic of the others, and since these persons do not turn up with great frequency in national surveys, we forego consideration of this type of living arrangement.

CHART 1. Proportion of U.S. Households Containing Persons Living Alone: 1940-83



the number of never-married persons living alone more than doubled during this period.

A second source of this trend is the increasing rate of marital dissolution through separation and divorce, since it is increasingly common for separated and divorced persons to head their own households rather than move back with their families of origin. Even as recently as the 1960s, high rates of movement back into relatives' households existed for divorced women. With the increased economic independence of women, these patterns have changed, and now there is a much greater propensity for divorced women to head their own households.

Finally, a third major component of this trend reflects the large number of older women living by themselves. The increase in this component is due to the increased ability of widowed women over this time period to remain in their households after the death of their spouse. Again, this is largely due to the greater longevity of women over men and the greater economic independence of women in contemporary society.

Single-Parent Households. A second major change in household composition in the U.S., is the increasing number of households composed of persons, 90 percent of whom are women, living alone with their children. Chart 2 shows this trend since 1948 and, beginning with 1968, displays the trend separately for whites and blacks as well.[5] Since 1950, when 7½ percent of family households were headed by a single parent, the proportion of single-parent family households has almost tripled. In 1984, some 26 percent of family households were so composed. The patterns of change in rates of single-parent households among blacks is particularly high—over 50 percent of black family households are headed by a single parent.

These changes in the number of single-parent households have their origins primarily in two sets of factors: (1) increasing rates of marital separation and divorce, and (2) increasing rates of never-married women with children heading their own households. The racial differences in the proportions of family households with only one parent are due in part to racial differences in rates of out-of-wedlock childbearing. And, while it is incorrect to assume that these patterns are restricted to blacks, changes among blacks have been considerably more substantial.

Although our focus here is primarily on the living arrangements of adults, it is important to note that these patterns reflect major changes in the living arrangements of children as well. According to data from the *Current Population Reports*, in the early 1980s nearly 20 percent of all children under the age of 18 were living in households headed by one parent, whereas in 1970 this figure was only 12 percent, a 75 percent increase. On the basis of projections of demographic trends in the two causal factors mentioned above, some demographers predict that upwards of 50 percent of all children born to parents in the early 1980s will spend a significant part of their lives prior to age 18 with only one of their parents.

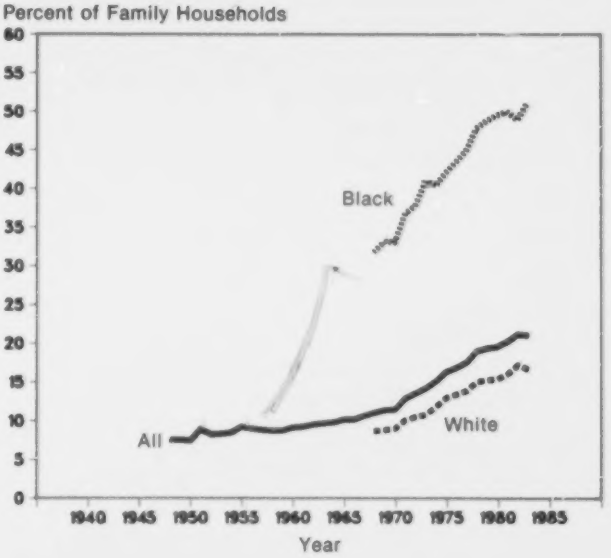
Consequences of these Trends

There is widespread agreement among students of marriage and family life that these trends in living arrangements result in part from changes in traditional family arrangements. Greater numbers of persons each year have been achieving more independent lifestyles at the expense of family membership, causing some to argue that the American household is becoming less familistic in its social arrangements.

The trends in living arrangements creating greater social isolation, namely increasees in numbers of persons living alone or living only with children, have broad implications for patterns of social contact and the quality of social life. The traditional view among mental health researchers is that social isolation is harmful, and the absence of immediate social supports for the problems of living is assumed to present potentially negative consequences. For example, the reported psychological well-being of married persons is consistently shown to be higher than that of currently unmarried persons, and one of the theoretical explanations of this difference refers to the relative isolation of the unmarried. Further, there is a vast amount of research in the epidemiological literature which suggests that social ties and relationships promote health and protect persons against disease. Contact with others is believed to make one more mentally and physically healthy by buffering the strains that result from major stressful life events and the problems of daily living. The presence (or absence) of "social others" has been linked to a variety of outcomes for individuals, including mental and physical health.

On the basis of these suggested patterns, our research—based on Quality of Life Survey data—investigated the extent to which it could be said that persons in non-traditional living arrangements were more socially isolated and experienced greater psychological stress than those living in more traditional circumstances. We examined two categories of variables, those measuring the amount of social integration (access to and contact with relatives, friends, neighbors, and confidants), and measures of self-reported psychological well-being (reported distress, positive affect, life satisfaction, and sense of personal control). Results of these efforts are reviewed in the following paragraphs.

CHART 2. Proportion of U.S. Family Households Containing Single Parents by Race: 1948-83



[5]These figures are the percentage of "family" households (those with children 17 and under) containing only one adult.

TABLE 2. Patterns of Frequencies of Visiting Friends by Living Arrangements, Marital Category, and Gender: 1978 Quality of Life Sample

Living Arrangements	Marital Category					
	Never Married	Now Married	Separated	Divorced	Widowed	Total
			Males			
Alone	.062	*−.158**	.153	.222	.137	.121
Children	—	*.062*	*.363*	−.327	*.493*	.065
Adults	.197	−.054	.050	−.078	*−.408*	−.008
Both	.233	−.167	*.381*	*.951*	*.912*	−.096
Total	.159	−.114	.166	.179	.168	−.019
n	297	1017	44	112	69	1539
			Females			
Alone	.193	*1.00*	.225	.120	.166	.177
Children	−.031	*.154*	.435	.290	.348	.288
Adults	−.085	−.163	−.250	−.082	−.180	−.154
Both	.366	−.043	−.223	.529	−.196	.003
Total	.125	−.094	.185	.216	.121	.013
n	280	1191	99	203	373	2146
P-values†						
a	ns	ns	ns	ns	ns	
b	ns	ns	.097	.043	.051	
c	.082	.005	ns	ns	ns	
Eta	.128	.086	.232	.199	.170	

*Entries in *italics* indicate cell size less than 10 cases.

†a = gender main effect; b = living arrangements main effect; c = gender by living arrangements interaction; ns = not statistically significant.

Living Arrangements and Social Integration. A detailed examination of patterns of social connectedness and social contact reveals a picture that runs counter to the assumption that persons living in solitary situations are more socially isolated than those living with others. Our results suggest that persons living alone engage in greater social contact outside of the household, clearly compensating for the absence of proximate social support naturally available to those who live with others. This pattern is revealed to some extent in Table 2, where we present average levels of frequency of contact with friends. For present purposes this variable is scaled so that scores have a mean of zero with a unit standard deviation. Positive numbers reflect greater frequencies of contact.

These results show that in several categories of marital status persons living apart from adult company tend to engage in greater social contact with friends than is true for those who live with other adults. The major exception to this involves the category of divorced men who live alone with children. But overall, persons living alone or alone with children have more friendly contact outside of the household. It is also generally the case that unmarried persons show many more visible signs of an active extrahousehold social life than is true for the married. And among the married, the presence of children seems to inhibit social contact with friends.

The above patterns are also supported by analyses of time diary data obtained from time-use studies, wherein time spent in the company of extrahousehold social partners is registered somewhat more accurately than the survey measures referred to above. These data also support the conclusion, evident in Table 2 as well, that women tend to exceed men in their frequencies of contact with friends outside of the household.

Living Arrangements and Subjective Well-Being. On the basis of the prevalent view that relative social isolation, as it is ostensibly reflected in the situation of living alone, is potentially harmful, our research examined several measures of psychological well-being. The existing theoretical literature would predict that those living alone will suffer a greater threat to their psychological well-being from such experiences than those living with others. In fact, our results are somewhat mixed on this issue. On some measures of well-being, those persons living alone evidence somewhat lower scores, but on others the results stand in sharp contrast to conventional wisdom. Indeed, by some indications those persons living alone show greater well-being and ability to deal with their life circumstances. This appears to be especially true for the category of widows living alone.

The potentially harmful effects of living alone, on the other hand, are also suggested in the data we examined. Such effects are most clearly demonstrated for our measure of psychological distress.[6] Table 3 presents the average levels of distress by living arrangements, marital status, and gender. As above, this variable is scaled so that scores have a mean of zero with a unit standard deviation, so that positive numbers reflect greater well-being.[7] The results

[6]This *distress index* is based on responses to the following questions: (a) How often does respondent (R) feel he is really enjoying life (all the time, fairly often, now and then, or rarely)? (b) Taking all things together, how happy is R (very happy, pretty happy, or not too happy these days)? (c) How often does R feel in low spirits or depressed? (d) Does anything make R feel frightened or worried? (e) Does R ever worry about having a nervous breakdown? and (f) five yes/no items from Bradburn's negative affect scale: During the past few weeks, has R felt so restless that he/she couldn't sit long?. . .felt very remote or lonely from other people?. . .felt bored?. . .felt depressed or very unhappy?. . .upset because of being criticized?

[7]This variable was residualized on chronological age prior to the tabulations in order to remove the effects of age on these patterns.

TABLE 3. Patterns of Distress by Living Arrangements, Marital Category, and Gender: 1978 Quality of Life Survey

Living Arrangements	Marital Category					
	Never Married	Now Married	Separated	Divorced	Widowed	Total
			Males			
Alone	−.150	—	−.057	−.106	−.103	−.113
Children	—	—	*.903**	−.132	*.214*	.119
Adults	.060	.289	.262	−.357	*.086*	.222
Both	.026	.197	*−.132*	*.001*	*.188*	.172
Total	−.031	.239	.150	−.143	−.096	.142
n	298	1017	44	112	69	1540
			Females			
Alone	−.179	—	−.516	−.541	−.278	−.314
Children	−.106	—	−.591	−.413	−.403	−.542
Adults	−.155	.078	−.492	−.170	−.182	.017
Both	−.080	.075	−.504	.344	−.118	.036
Total	−.223	.069	−.544	−.357	−.301	−.101
n	280	1191	99	203	373	2146
P-values†						
a	ns	.000	.001	.083	ns	
b	ns	ns	ns	.045	.094	
c	ns	ns	ns	ns	ns	
Eta	.214	.097	.331	.221	.154	

*Entries in *italics* indicate cell size less than 10 cases.

†a = gender main effect; b = living arrangements main effect; c = gender by living arrangements interaction; ns = not statistically significant.

indicate that persons living alone are marginally more distressed than comparable persons living with others. In addition, they show that the circumstance of being a single-parent woman living alone with children is also linked to lower relative scores on this measure, with such women suffering at least as much distress as those living alone.

The above patterns were also examined in the context of a multivariate analysis that controlled the respondent's health, household income, the experience of stressful life events, and the respondent's degree of social integration outside of the household. These analyses (not presented here) reveal few independent structural effects of living arrangements per se, although there are some instances, e.g. among divorced women, in which there does appear to be an independent negative effect on well-being.

Another striking result of these multivariate analyses, which occurs with considerable consistency over different outcomes, is the apparent negative consequence of being in the category of women living alone with children. The most visible pattern of this type is among never-married women in this category, although it is clearly present among separated and divorced women as well. In none of these cases, however, is the effect of single parenthood statistically significant. Thus, it seems appropriate to conclude that, although there is a relationship between living arrangements and psychological well-being, the causal effects appear to be largely due to the conditions which produce various living arrangements rather than to the living arrangements themselves.

Prospects and Implications

Whatever may be the long-term trends in U.S. living arrangements, there appear to be few harmful effects suffered by persons living by themselves in modern society. Some such marginal harmful effects, which cannot be allocated to antecedent factors, apparently exist for some categories of persons, but in general these effects are small. As noted above, living alone appears to be an arrangement of choice in many cases, and it is not necessarily a catastrophic situation into which persons are forced against their will. And even in some instances where it does occur involuntarily, e.g. for widows, living alone seems to be associated primarily with positive outcomes.

While our results have much in common with previous analyses, those concerning the situation of single-parent women depart from existing knowledge in important ways. Such women typically suffer from limited income, residential instability, and a variety of additional sources of stress and strain. These patterns reflect aspects of life quality both for the women involved and for their children. And owing to the expectation that the events precipitating these patterns of living are likely to continue as a part of our collective social experience, these contours of the data may represent a basis for the re-examination of social policy. There is a need for a consideration of the adequacy of current forms of income support and child-care assistance for single-parent families. Policymakers and funding agencies concerned with the welfare of children need to consider a wide range of issues regarding the well-being of children in single-parent families, including issues of the availability of resources, both social and psychological, that lessen the strains of childrearing.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Actual		Proj.
	83:3	83:4	84:1	84:2	84:3	84:4	85:1	85:1	85:2	85:3	85:4	86:1	1983	1984	1985
GROSS NATIONAL PRODUCT	3,347	3,432	3,553	3,645	3,695	3,759	3,817	3,821	3,896	3,171	4,045	4,125	3,305	3,663	3,933
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	215.9	218.2	220.6	222.4	224.6	226.1	229.2	227.9	229.8	232.0	234.8	237.0	215.3	233.4	231.1
CORPORATE PROFITS AFTER TAXES	142.6	141.1	150.6	150.2	141.7	141.0	140.0	146.0	152.0	157.0	160.0	161.5	127.4	145.9	153.0
UNEMPLOYMENT RATE (percent)	9.33	8.47	7.87	7.50	7.47	7.20	7.33	7.20	7.00	7.00	6.90	6.80	9.58	7.51	7.00
INDUSTRIAL PRODUCTION (index, 1967 = 100)	151.8	155.5	159.8	163.1	165.6	164.7	165.4	167.8	169.3	170.9	173.0	174.0	147.6	163.3	170.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.786	1.716	1.947	1.858	1.663	1.598	1.793	1.690	1.730	1.750	1.710	1.625	1.703	1.766	1.705
CONSUMER PRICE INDEX* (% change from prior quarter or year)	4.24	4.11	5.29	3.74	3.67	3.54	3.30	3.30	3.50	3.90	4.10	4.30	3.19	4.28	3.55
3-MONTH TREASURY BILL RATE (%)	9.19	8.79	9.13	9.84	10.34	8.97	8.18	7.97	8.23	8.50	8.83	8.70	8.62	9.57	8.42
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	12.68	12.76	12.94	14.18	13.72	12.63	12.61	12.35	12.18	12.55	12.75	12.30	12.25	13.37	12.43
GNP IN 1972 DOLLARS	1,550	1,573	1,611	1,639	1,645	1,662	1,665	1,678	1,694	1,710	1,725	1,739	1,535	1,639	1,702
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	1,016	1,032	1,044	1,064	1,066	1,075	1,089	1,089	1,100	1,109	1,119	1,126	1,009	1,062	1,104
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	172.6	184.5	193.3	202.9	209.5	213.8	215.2	219.0	222.9	226.0	228.5	232.0	171.0	204.9	224.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	57.2	57.8	60.6	60.8	60.1	59.2	59.4	59.6	61.0	61.3	61.5	61.0	53.7	60.2	61.0
CHANGE IN BUSINESS INVENTORIES (1972 $)	0.9	7.2	31.6	20.3	30.6	16.8	19.6	14.5	16.0	16.0	17.0	16.3	-3.6	24.8	15.3
NET EXPORTS (1972 $)	11.9	2.0	-8.3	-11.4	-27.0	-13.4	-27.0	-18.4	-20.0	-21.3	-23.0	-22.6	12.6	-15.0	-20.8
FEDERAL GOVERNMENT PURCHASES (1972 $)	115.6	113.0	112.2	123.2	125.0	129.6	128.2	130.0	131.8	133.0	134.0	134.1	116.2	122.5	132.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	176.4	175.8	177.3	178.9	181.1	180.9	181.0	183.1	184.1	186.0	187.0	187.4	175.7	179.5	185.0

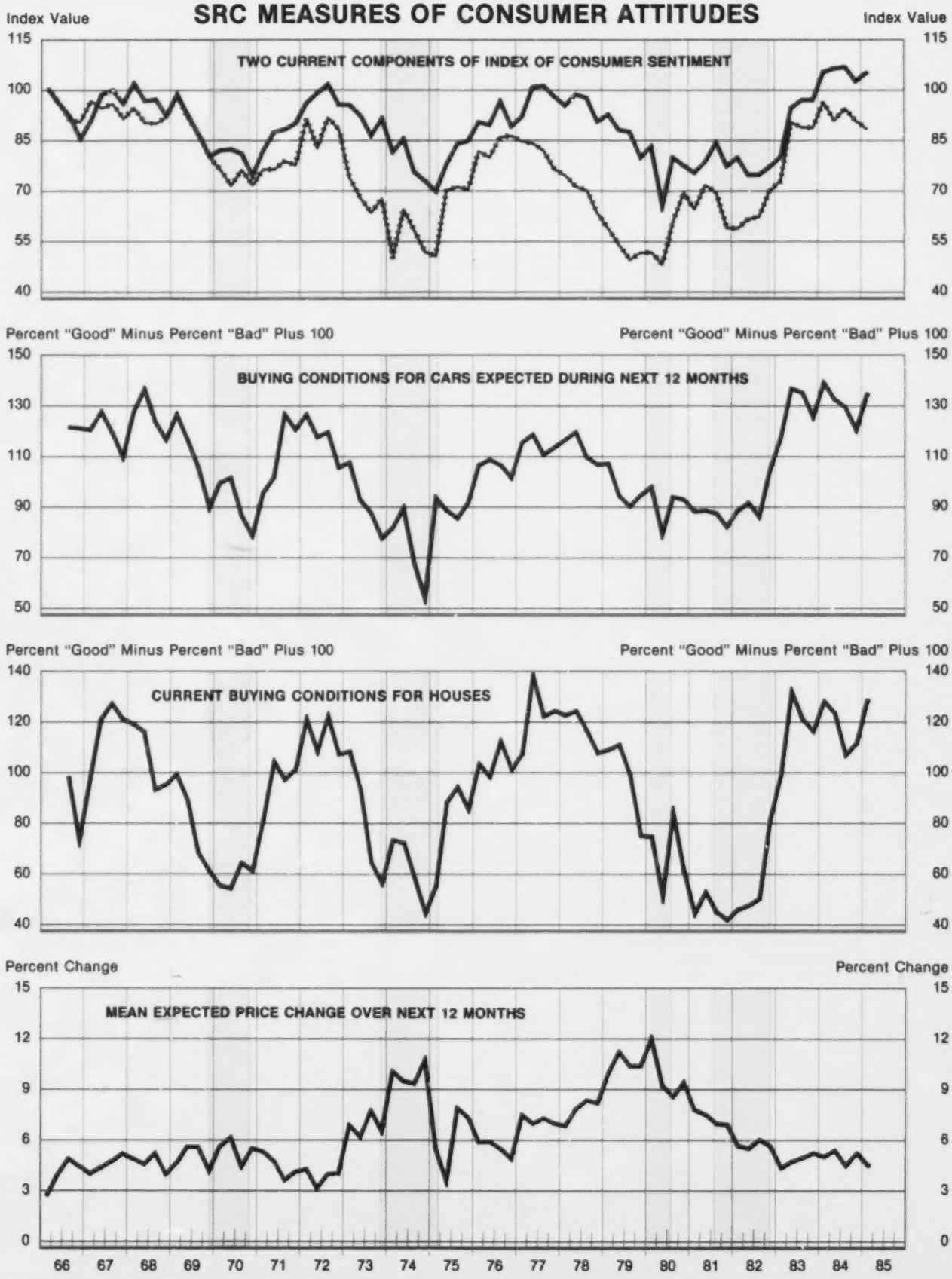
SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	82:2	82:3	82:4	83:1	83:2	83:3	83:4	84:1	84:2	84:3	84:4	85:1	1982	1983	1984
GROSS NATIONAL PRODUCT	3,061	3,080	3,110	3,174	3,267	3,347	3,432	3,553	3,645	3,695	3,759	3,817	3,069	3,305	3,663
PERSONAL CONSUMPTION EXPENDITURES	1,961	2,001	2,046	2,070	2,142	2,181	2,230	2,277	2,333	2,361	2,396	2,446	1,985	2,156	2,342
GROSS PRIVATE DOMESTIC INVESTMENT	431.2	415.9	376.2	405.0	449.6	491.9	540.0	623.8	627.0	662.8	637.8	651.2	414.9	471.6	637.9
NET EXPORTS	35.5	6.6	6.3	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-56.0	-69.1	19.0	-8.3	-64.2
GOVERNMENT PURCHASES	633.7	656.3	681.0	678.8	682.2	689.8	691.4	704.4	743.7	761.0	780.5	789.0	650.5	685.5	747.4
DISPOSABLE PERSONAL INCOME	2,157	2,196	2,238	2,261	2,303	2,367	2,429	2,502	2,554	2,606	2,645	2,653	2,181	2,340	2,577
PERSONAL SAVING RATE (% of disposable income)	6.3	6.1	5.8	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.2	4.5	6.2	5.0	6.1

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late May, and projected data, released by ASA-NBER in March, are displayed for first quarter 1985.

Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

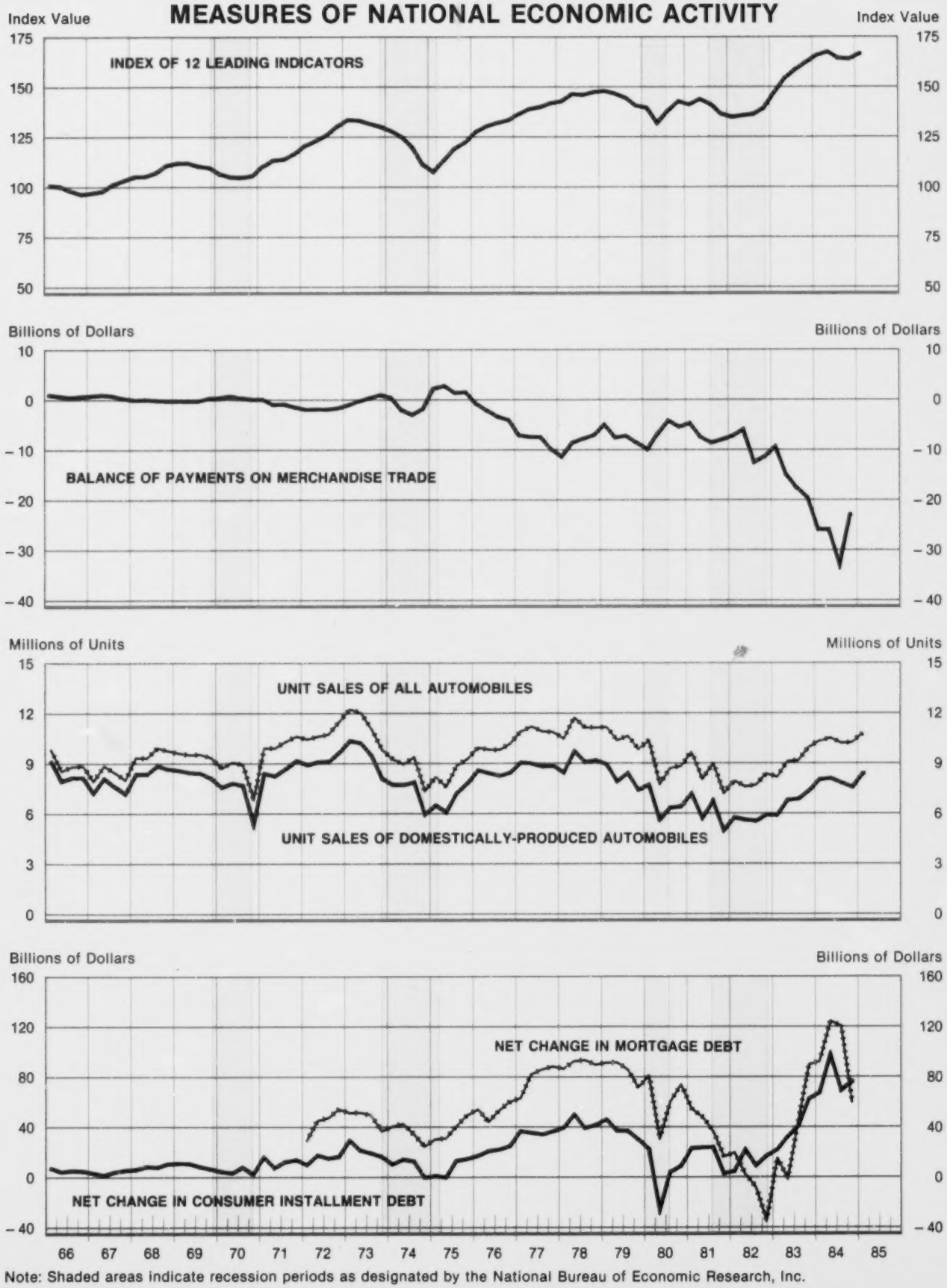
*Substantial revision of the data for variables marked with an asterisk has occurred since the last printing.

SRC MEASURES OF CONSUMER ATTITUDES



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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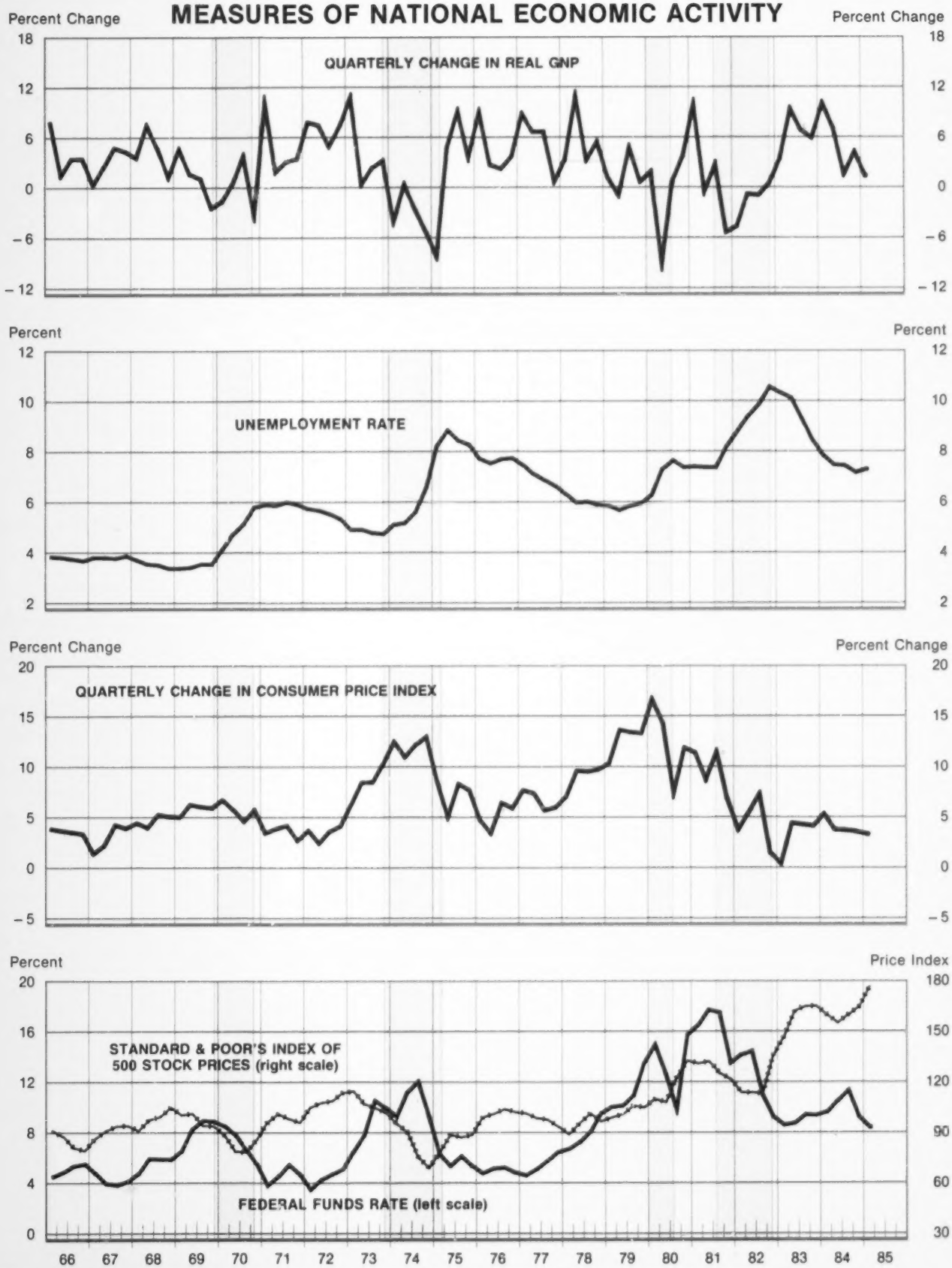
MEASURES OF NATIONAL ECONOMIC ACTIVITY



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FEDERAL POLICY AND THE MOBILITY OF OLDER HOMEOWNERS:
The Effects of the One-Time Capital Gains Exclusion

by Sandra Newman and James Reschovsky

This new research report presents the first systematic evaluation of the 1978 capital gains exclusion provision for older homeowners.

Originally enacted in 1964, Section 121 of the Internal Revenue Code has allowed older homeowners who sell their homes to elect a one-time-only exclusion from taxable income of some or all of the capital gains realized by a sale. The 1978 amendment dropped the lower age limit for this provision from 65 to 55 and raised the upper limit on excludable gain from $35,000 to $100,000. (A 1981 amendment later raised the excludable gain once again, to $125,000.)

The one-time capital gains exclusion provided by Section 121 addresses the tax situation of older homeowners, who are presumably more likely to want to "downgrade" by selling a larger family home in order to buy a smaller home or to move into rental housing. Without such an exclusion, older homeowners facing substantial capital gains tax liabilities might tend not to sell their larger homes, creating an undesirable "lock-in" effect that would slow turnover in both the real estate and the mortgage markets.

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The authors find that the provision has prompted a small increase in residential mobility among older homeowners, but these are not the downgrading types of moves that had been expected.

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Volume 12 Number 3

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THE UNIVERSITY OF MICHIGAN

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Reappraising Social Security Fifty Years Later

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ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis of this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

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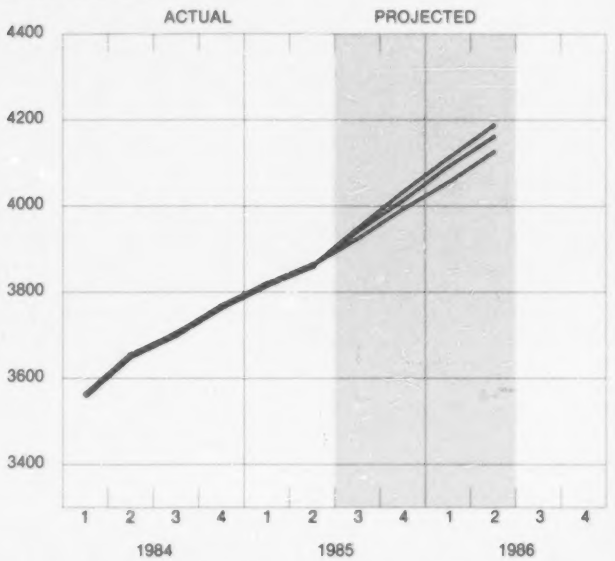
ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

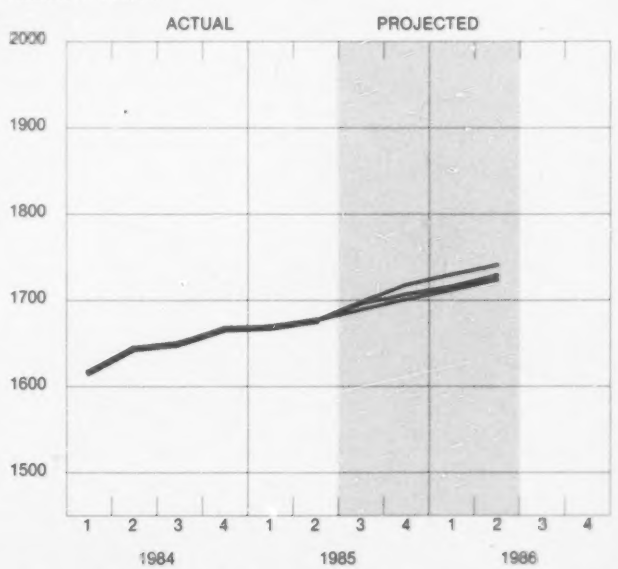
IN CURRENT DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Buyer's Market: Discounts Become The Norm

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

In the second quarter 1985 survey, the Index of Consumer Sentiment was 94.3, insignificantly below the 94.5 recorded one quarter earlier, and just 5.2 Index-points below the 1984 cyclical peak of 99.5 (see the chart below). The Index has remained at very favorable levels for over two years, with the second quarter figure above the two-year-earlier reading of 91.5. This represents the longest sustained period of favorable economic assessments since the 1960s.

Lower interest rates and favorable perceptions of market prices have maintained buying attitudes at record favorable levels. Although consumers expected slow economic growth during the year ahead in the second quarter survey, they expected it to be accompanied by low rates of inflation and to lead to only small increases in the unemployment rate. This outlook for slow but sustained growth, given the economic turbulence of past years, has supported the view that good times financially will continue in the country as a whole.

Buying Attitudes Regain Peak Levels

In the second quarter 1985 survey, favorable attitudes toward buying conditions regained the cyclical peak levels that were first recorded two years earlier. The recent improvement in buying attitudes has been due to lower interest rates on consumer loans. In addition, favorable perceptions of market prices continue to support these positive buying attitudes.

While the extent of the current improvement has been comparable to prior cycles, the reasons given by consumers for holding these favorable buying attitudes have changed substantially. The cyclical peaks recorded in the 1970s were driven by an inflationary psychology, which created incentives to purchase in advance of the then escalating inflation rates. At the present time, very few consumers cite the advantage of buying in advance of rising prices. In contrast, the current recovery has been built on widespread reports of the availability of price discounts. It is now the positive appeal of discounted prices, not the negative pressures to act before further increases, that determines consumer reactions to prices.

Whereas the 1970s were characterized by higher and more variable inflation rates, in the 1980s higher and more variable interest rates represent the primary source of uncertainty about future buying conditions. As a result, consumers now view interest rate trends as the most important factor in the timing of their purchases. While negative reactions by consumers to increases in interest rates have been repeatedly documented, only in the 1980s have declines in interest rates become a major factor in purchase decisions.

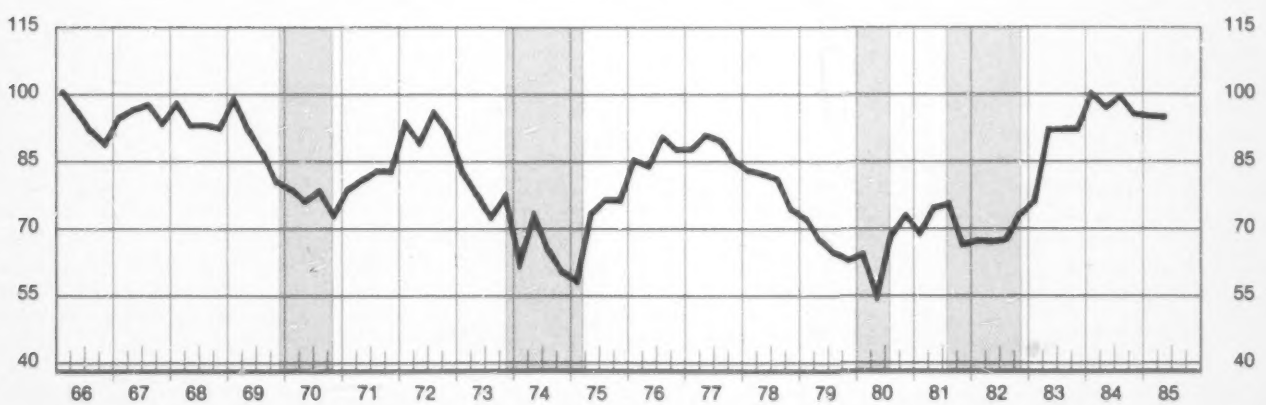
As a result of these changes in consumer attitudes, the availability of price and interest rate discounts has become the expected norm.

Homes. In the second quarter 1985 survey, the proportion of families that held favorable attitudes toward buying conditions for homes rose to 64 percent, reversing the small decline recorded in the second half of 1984, and equal to the cyclical peak first recorded in the second quarter of 1983. The highest proportion ever recorded was 65 percent in the second quarter of 1977.

Although home-buying attitudes are now as favorable as in the late 1970s, the reasons underlying these favorable views are quite different. Whereas in the late 1970s consumers evaluated buying conditions in terms of expected future prices, consumers now hold favorable perceptions of current prices. At the 1977 peak, 46 percent supported their

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

favorable views by referring to the advantages of buying in advance of rising prices. In comparison, at the 1984 peak just 9 percent gave buy-in-advance price rationales. At the 1977 peak, just 4 percent of all families mentioned the availability of reduced home prices, compared with 22 percent that complained about high prices. In the second quarter 1985 survey, 17 percent mentioned the appeal of currently low home prices, while 14 percent viewed current prices as too high and cause for postponement. Throughout the past two years, favorable references to current home prices have outnumbered unfavorable references, a trend not seen since the 1960s.

In addition to shifting price perceptions, the current recovery in attitudes is distinctive in its reliance on interest rate trends. In the second quarter 1985 survey, 49 percent of all families cited trends in mortgage interest rates in support of their favorable assessments. At the 1977 peak, in comparison, just 12 percent of all families favorably mentioned interest rates when asked to explain their views. During the past year, the reasons underlying these favorable references to mortgage interest rates have shifted from the appeal of borrowing in advance of expected increases to the current availability of lower rates. In the second quarter 1985 survey, 40 percent of all families mentioned the current availability of reduced mortgage interest rates, up from 25 percent one year earlier. References to the advantages of borrowing in advance of future increases in mortgage rates fell to 9 percent in the second quarter of 1985 from a peak of 20 percent one year earlier.

Vehicles. In the second quarter 1985 survey, favorable attitudes toward buying conditions for cars reached new record levels. Among all families, 67 percent held favorable car-buying attitudes, just above the prior record of 65 percent set in the second quarter of 1983. The recent improvement, which completely offset the small decline recorded in late 1984, was due to the increased availability of reduced prices and interest rates on vehicle loans. During the past six months, references to price discounts rose to 26 from 18 percent, and references to the current availability of reduced interest rates on vehicle loans rose to 26 from 12 percent.

Household Durables. In both the first and second quarter 1985 surveys, 74 percent of all families held favorable attitudes toward buying conditions for large household durables. This is the highest proportion ever recorded, just above the prior record of 72 percent recorded in the second quarter of 1984. The maintenance of buying attitudes at these very favorable levels has been due to favorable perceptions of current prices. Among all families in the second quarter 1985 survey, 37 percent mentioned the availability of price discounts on household durables, just below the all-time record of 41 percent recorded one quarter earlier. Just 10 percent of all families complained about high prices in the second quarter 1985 survey. On balance, these trends represent the most favorable perceptions of market prices for large household durables since the 1960s.

Personal Finances Remain Favorable

Consumers' evaluations of their own financial situation have remained unchanged at favorable levels since the start of 1985. In the first and second quarter 1985 surveys, 41 percent of all families reported that their financial situation had improved, just below the cyclical peak of 45 percent recorded in the first half of 1984. The small decline since 1984 has been due to slower growth in family incomes. Despite this small decline, personal financial evaluations have been more favorable during the past year than during the prior ten years. The primary reason for the sustained improvement in personal finances has been the sustained declines in inflation. This stands in sharp contrast to the pattern recorded during the economic recovery of the late 1970s, when personal finances were increasingly strained by escalating inflation.

Consumers continue to favorably view prospects for their financial situation during the year ahead, in large part because they expect low inflation rates to be maintained. Among all families in the second quarter 1985 survey, 36 percent expected their financial situation to improve, essentially unchanged from the 37 percent recorded one year earlier. Only 11 percent of all families expected their financial situation to worsen during the year ahead. Families' evaluations of their overall financial situation have remained largely unchanged during the past year, reflecting the offsetting impact of slower expected growth in incomes as well as prices. Among all families in the second quarter 1985 survey, the proportion that expected income increases fell to 57 percent from 62 percent one year earlier, and the proportion that expected increases of 6% or more fell to 30 from 36 percent. At the same time, the expected annual rate of inflation fell to 4.9% in the second quarter 1985 survey from 5.3% one year earlier.

The maintenance of personal finances at favorable levels, coupled with declines in interest rates, have led consumers to be more willing to use credit to finance major purchases. In the second quarter 1985 survey, 30 percent of all families reported that they were not reluctant to use credit, just above the 29 percent recorded one year earlier, and the highest level recorded in nearly a decade. Willingness to use accumulated savings to make major purchases was reported by 40 percent of all families in the second quarter of 1985, just below the decade high of 42 percent recorded one year earlier.

Prolonged Slow Growth Expected, But No Recession

Although the rapid upward momentum in the national economy has now ended, few consumers expect the economy to slide into recession during the year ahead. Even the slow pace of economic growth expected during the year ahead, following the strong recovery, has meant to consumers the continuation of good time financially in the country as a whole. These favorable overall assessments of economic prospects reflect the substantial positive influence of continued low rates of inflation, partially offset by rising concerns with the more limited job prospects due to slower growth.

In the second quarter 1985 survey, the proportion of families that thought the national economy had improved during the past year was 53 percent, down from 68 percent in the second quarter of 1984. The proportion of families that expected the economy to improve during the year ahead fell to 28 percent in the second quarter 1985 survey, from the cyclical peak of 52 percent in the second quarter of 1983. Most of this decline was recorded one year ago, when the proportion that expected improvement fell from 52 to 31 percent from 1983 to 1984. During the past year only a small further decline was recorded—from 31 to 28 percent.

Although the proportion of families that expected further improvements has fallen sharply in the last two years, only a small increase was recorded in the number of families that expected worsening economic conditions. Much of the shift in opinion was toward the expectation of an unchanged economy, and much of this shift was recorded one year ago. In the second quarter 1985 survey, 55 percent of all families expected unchanged business conditions, just above the 53 percent recorded one year ago, but significantly above the 39 percent recorded two years earlier. Just 15 percent of all families in the second quarter 1985 survey expected the economy to worsen, up from 14 percent in 1984 and 7 percent in 1983.

Good times financially in the economy as a whole were expected by 57 percent of all families in the second quarter 1985 survey, only marginally below the 61 percent recorded both one and two years earlier. Although the 1985 figure is the lowest recorded during the past two years, these assessments were nonetheless more favorable than at any other time since the 1960s.

Declines in the aggregate unemployment rate were expected by 18 percent of all families in the second quarter 1985 survey, down from 27 percent one year earlier and the cyclical peak of 40 percent two years earlier. Rising unemployment rates were expected by 27 percent of all families in the second quarter of 1985, up from 20 percent one year earlier and 15 percent two years earlier. The majority of families in the 1985 survey expected the unemployment rate to remain largely unchanged during the year ahead.

Interest rates were expected to increase during the year ahead by 42 percent of all families in the second quarter 1985 survey, just above the 39 percent recorded one quarter earlier, but substantially below the 66 percent recorded one year earlier. Declines in interest rates were expected by 21 percent of all families in the second quarter 1985 survey, down from 24 percent one quarter earlier, but above the 9 percent recorded in 1984.

Summary Outlook

Consumer sentiment has remained at very favorable levels for more than two years, the highest sustained period since the 1960s. But in sharp contrast to the optimism of the 1960s, no boom psychology has developed in the 1980s. Concern with the long-term viability of the economy, especially with more limited job prospects in an era of increasing international competition, has caused consumers to adopt a more cautious outlook. Growth in personal incomes is expected to be slow but positive due to the lower rates of inflation expected to prevail. And as the period of expansion has lengthened, consumers have increasingly expected the rate of improvement to slow. That no recession is expected reflects the confidence consumers have in their anticipation of only small changes in economic trends during the year ahead. Despite the sluggish growth expected, it is this sense of renewed economic stability, in contrast to the past decade of volatility and uncertainty, that underpins the maintenance of favorable economic assessments.

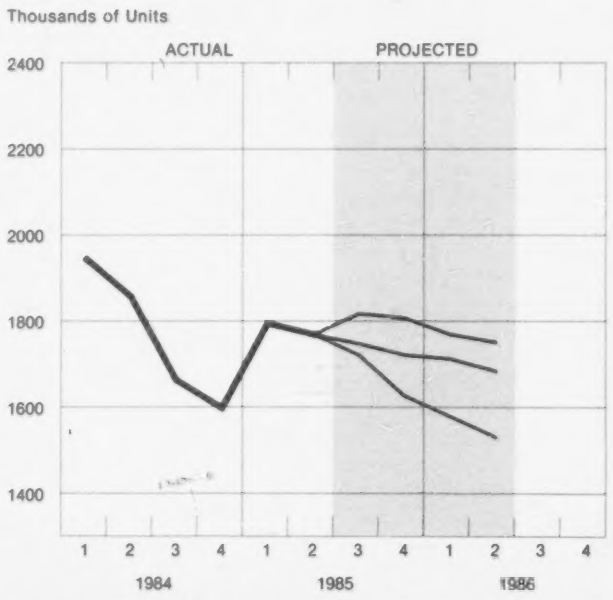
The single most important factor in shaping recent developments in consumer attitudes and expectations has been that the current expansion has not been accompanied by rising inflation. Consumers now perceive a new advantage in the market place. Gone are the days when consumers felt pressured to act by ever-escalating prices. Today, consumers are more willing to engage in comparative price shopping and expect to be enticed by discounts on prices as well as interest rates. Rather than the consumer scrambling to keep up with price increases, now sellers must scramble to keep up with the more demanding consumer. These data indicate that consumer purchases of homes, vehicles, and large durable goods will remain at high levels through the start of 1986, but the maintenance of sales at high levels will depend on the continued availability of price and interest rate incentives.

August 1985

Another publication of interest to our readers. The current issue of *The Research News*, a bimonthly publication of the Division of Research Development and Administration of The University of Michigan, features the work of researchers associated with the Economics Department's Research Seminar in Quantitative Economics and our own Surveys of Consumer Attitudes.

The issue, titled "The Economy: Plotting What Lies Ahead," is available free of charge to anyone who requests a copy. Such requests should be sent to *The Research News*, The University of Michigan, 241 West Engineering, Ann Arbor, MI 48109. A copy may also be ordered by calling (313)-763-5587.

NEW PRIVATE HOUSING UNITS STARTED



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Mid-Year Review and Forecast: The U.S. Economic Outlook for 1985-86

Saul H. Hymans and Joan P. Crary
Research Seminar in Quantitative Economics
Department of Economics
The University of Michigan

The Current State of the Economy: The Facts

A year ago most of us were celebrating the great gains of the (then) record recovery from the 1981-82 recession. President Reagan, campaigning for re-election, asked confidently all along the campaign trail whether we weren't a good deal better off than we had been four years earlier. In a presidential election, it appears, a good-news backcast beats a bad-news forecast any day. And all that Walter Mondale had to offer was a vision of problems on the economic horizon: problems because of the federal deficit and high interest rates, problems because of job losses to foreign competition, problems whose solution would ultimately necessitate higher taxes and other such bitter pills. Not a message to win friends or votes in 1984.

A year later, the news is not quite as upbeat. During the past year, as measured from the 2nd quarter of 1984 to the 2nd quarter of 1985, real GNP has increased by just under 2 percent. The unemployment rate registered 7.5 percent last July, made it down to 7.1 percent in November '84, got back up to 7.4 percent in January, and has been stuck at 7.3 percent from February through the latest reading for this July.

The economic expansion—if it hasn't been entirely derailed—is certainly off the fast track. How bad have things gotten in the past year? Exactly what has happened to the state of demand and production, and how can we understand recent events in order to help shed some light on what may be in the offing.

We begin to deal with these issues through the data compilation shown in Table 1. All of the constant dollar data in the table have been calculated as half-year averages in order to smooth out some of the quarterly gyrations. The growth recession that appears to have developed during the past year is summarized in the bottom line of Table 1, which shows total U.S. production (real GNP) from the second half of 1982—the bottom of the 1981-82 recession—through the first half of 1985. Following a small decline (0.5 percent at annual rate) in the second half of '82, real GNP grew progressively more rapidly in each of the next three half-years, reaching a peak growth rate of 8.3 percent between the second half of '83 and the first half of '84. Since then, the growth of U.S. production has fallen progressively, to 3.6 percent for the second half of 1984 and to an anemic 1.6 percent for the first half of this year. The purpose of the first three lines of Table 1 is to account for the bottom line by examining aggregate demand in a slightly unusual way which happens to be instructive in the current situation.

Line (1) in the table shows—in real terms, by half-year—the total final purchases by U.S. residents of all goods and services *wherever produced*, whether in the U.S. or abroad. This measures the underlying strength of final demand in the domestic economy and is labled Domestic Demand. While the *pattern* of growth in Domestic Demand is precisely the same as that in U.S. production, the *amplitude* of the growth cycle is markedly less in Domestic Demand. Although the growth rate of demand for goods and services by U.S. residents has slowed during the past year, it has remained high by any absolute standard. There is nothing weak about demand growing at a 4.3 percent rate (2nd half '84 to 1st half '85) two and a half years into an economic expansion. To what extent, however, has Domestic Demand shunned domestically produced goods and services?

Line (2) of Table 1 removes imported goods and services from Domestic Demand to show the pattern of Domestic Demand for Domestic Production. The real story here is centered in the year and a half from the first half of '83 to the second half of 1984. During this period total Domestic Demand rose by 150 billion 1972 dollars (annual rate), but only about two-thirds of that demand growth ($101 billion) was satisfied out of domestic production. Imported goods and services, which accounted for just under 8 percent of Domestic Demand in the first half of '83, picked up nearly 33 percent of the growth of demand during the next year and a half to bring its share of total demand to over 10 percent by the second half of 1984. The data show little further deterioration due to imports between the second half of '84 and the first half of this year.

During the year-and-a-half period when imports picked up about one-third of the growth of Domestic Demand, the U.S. dollar was rising by 19 percent against a trade-weighted average of other currencies; and, indeed, the dollar had been rising steadily for 2½ years coming into the first half of 1983. Under these conditions, there was virtually no way that imports could fail to gain a competitive advantage over domestically produced goods. Had this not occurred, had the import share of Domestic Demand remained at its first half '83 level, Domestic Demand for Domestic Production would have been considerably higher in the first half of this year: higher by 39 billion 1972 dollars based on the actual level of Domestic Demand in the first half of 1985, though this is surely an overestimate since higher prices would have reduced total demand to some extent.

U.S. producers turn out goods and services to satisfy both domestic and foreign demand. By adding exports to the Domestic Demand for Domestic Production shown in line (2) of Table 1, we arrive at World-Wide Demand for U.S. Production shown in line (3). In general, foreign demand for U.S. output has grown somewhat more slowly than our own demand for U.S. output, again at least partially in response to the strength of the U.S. dollar, which tilts competitively against U.S. goods. And in contrast to imports, which gained little ground between the second half of '84 and the first half of this year, exports weakened considerably in the first half of '85 so that World-Wide Demand for U.S. Output rose at a rate of only 3 percent—the weakest performance of any half year since the end of the 1981-82 recession. Interestingly, a good deal of the deterioration in real exports this year derives from lower real factor incomes, the reduced domestic purchasing power of the foreign currency

TABLE 1. U.S. Production by Half Years, 2nd Half 1982 to 1st Half 1985
(Billions of 1972 Dollars)

	1982	1983		1984		1985	Percent Change 2nd Half '82 to 1st Half '85	
	2nd Half	1st Half	2nd Half	1st Half	2nd Half	1st Half	Total	Annual Rate
(1) Domestic Demand: Final Purchases by U.S. of All Goods and Services	1468.6	1500.0	1500.4	1608.8	1650.3	1685.8	14.8	5.7
(% change, annual rate)	(2.2)	(4.5)	(6.7)	(7.7)	(5.2)	(4.3)		
(2) Domestic Demand for Domestic Production: Final Purchases by U.S. of U.S. Produced Goods and Services	1351.8	1381.6	1416.05	1454.1	1482.8	1513.4	12.0	4.6
(% change, annual rate)	(2.7)	(4.5)	(5.0)	(5.4)	(4.0)	(4.2)		
(3) World-Wide Demand for U.S. Production	1493.4	1519.2	1557.4	1598.9	1630.1	1654.6	10.8	4.2
(% change, annual rate)	(0.8)	(3.5)	(5.1)	(5.4)	(3.9)	(3.0)		
(4) U.S. Production (= Real GNP)	1478.0	1507.9	1561.4	1624.8	1653.8	1667.1	12.8	4.9
(% change, annual rate)	(-0.5)	(4.1)	(7.2)	(8.3)	(3.6)	(1.6)		

Definitions:
Line (1): Real Final Sales less Real Net Exports of Goods and Services (= Real Final Sales to Domestic Purchasers in the GNP Accounts).
Line (2): line (1) less Real Imports of Goods and Services.
Line (3): line (2) plus Real Exports of Goods and Services (= Real Final Sales in the GNP Accounts).
Line (4): line (3) plus Real Change in Business Inventories (= Real GNP).

earnings of all U.S. factor services supplied abroad—a direct result of the weakness of foreign currencies against the American dollar.

The result of going from line (1) to line (3) is to show that the growth of World-Wide Demand for U.S. Production has lagged far behind the growth of Domestic Demand during the entire economic recovery process since 1982. On balance, we have been exporting economic growth to the economies of our major trading partners. While our own Domestic Demand hit a boom-level peak growth rate of 7.7 percent in the first half of 1984, the corresponding peak growth rate of World-Wide Demand for U.S. Production amounted to only 5.4 percent. We've not experienced a period of real boom growth in World-Wide Demand for our output at any time in the past three years!

By adding real inventory investment to line (3), we arrive at real GNP shown in line (4). It was the sharp inventory build-up between the second half of 1982 and the first half of 1984 that translated the distinctly modest pace of World-Wide Demand for our output into a boom in U.S. production. That process has reversed itself during the past year, as World-Wide Demand slowed from a 5.4 percent growth rate a year ago to a 3 percent growth rate for the first half of this year. U.S. producers had little reason to keep building inventory stocks as rapidly as had been necessary following the run-down of stocks during the 1981-82 recession.

The Current State of the Economy: The Lessons

The data in Table 1 not only describe what has happened in recent years, they also help in thinking about what may be ahead. For descriptive purposes we read the table from the top down to try and understand what happened to real GNP. But the process requires also that we go from the bottom line, real GNP, back to the top line, Domestic Demand. It is real GNP—our own production of goods and services—that generates employment and real income for U.S. residents and thus the level and growth of Domestic Demand. If too much Domestic Demand is lost to imports relative to what comes back via exports, we must ultimately find real GNP running weak. This, in turn, will imply weakness in domestic employment and income, and, inevitably, a weakening of Domestic Demand.

A continually worsening imbalance in our foreign trade accounts implies a progressively more sluggish domestic economy. To get real GNP growing more rapidly again—other than temporarily as the result of an inventory

upswing—requires that we deal effectively with those factors which have accounted for the strong dollar and the consequent deterioration in our foreign trade position. If we succeed in this regard, we can turn our economic growth rate back up. If we fail, the likely implication is a recession or a period of stagnation long enough finally to take the bloom off the U.S. dollar.

The dollar has to come down, one way or the other. We can and should try to accomplish this with policies which will be supportive of an orderly weakening of the dollar and a simultaneous strengthening of the domestic economy. Those who argue that the cost of a weaker dollar is a higher average price level in the U.S., as we are forced to import at generally higher dollar-denominated prices, are absolutely right; that's the cost and we should pay it, since the alternatives are clearly worse.

Some critics of dollar-weakening policies note rightly that our huge trade deficit implies an equally huge inflow of dollars on capital account. But then they claim that such a dollar inflow is beneficial because it finances our federal budget deficit and thereby keeps interest rates lower than they would otherwise be—an argument that misses the real point. The dollar inflow on capital account simply returns to the U.S. the dollars lost through the imbalanced trade account; overall domestic liquidity is unaffected. What *does* keep interest rates lower than they would otherwise be is the worsening trade imbalance, which slows down the domestic economy and—like anything that cuts down our level of economic activity—takes some pressure off interest rates. We don't get interest rates that are lower-than-otherwise for free; we pay for them with a more sluggish domestic economy.

The U.S. dollar has already slipped a good 15 percent against a trade-weighted average of other currencies since its peak in February of this year. As we go on to discuss input assumptions for this forecast, we shall consider the relations between various government policy inputs and the strength of the dollar.

Fiscal Policy Inputs

When the 99th Congress got to work, the professed top priority of the leadership of both political parties was permanent deficit reduction. The goal was to adopt a budget that would trim the deficit by at least $50 billion in fiscal 1986 and set the stage for further substantial savings in red ink thereafter. There's always a good deal of game-playing in matters of this sort. A budget enacted is an expenditure plan, and one never really knows how much "saving" can legitimately be claimed against some non-existent budget that might otherwise have come into being. Despite this, the FY '86 compromise budget agreed to just prior to the scheduled start of the Congressional summer recess is claimed to represent a saving of about the desired $50 billion.

Our best estimate is that federal expenditures in the National Income and Product Accounts will total just over $973 billion in fiscal '86, up $34 billion or 3.6 percent over the expenditure total we are projecting for fiscal '85, which has two more months to run (see Table 2). In the three years since fiscal '82, federal spending has risen by an average of 8¼ percent per year. If that is taken to represent the "business-as-usual" increase that might otherwise have occurred in fiscal '86, then an increase estimated at only 3.6 percent represents a budget cut of about $43 billion.

TABLE 2. Federal Government Expenditures and Receipts (National Income and Product Accounts, billions of dollars)

Expenditures, Receipts, and Deficit	Fiscal 1984[1]	Fiscal 1985[1]	Fiscal 1986	Fiscal 1987
Total Expenditures	859.5	939.4	973.3	1005.8
Purchases of Goods and Services	283.1	322.4	339.6	354.8
National Defense	215.4	237.6	255.4	270.7
Nondefense	67.6	84.8	84.2	84.1
Transfer Payments	350.4	367.1	380.5	392.6
Unemployment Benefits	17.0	16.5	15.8	15.6
Grants-in-Aid to State and Local Governments	90.6	97.2	91.8	88.0
Net Interest Paid	110.6	130.1	144.9	159.5
Subsidies less Current Surplus of Gov't. Enterprises	24.8	22.6	16.5	11.0
Total Receipts	688.0	745.7	784.8	836.1
Deficit (-)	-171.5	-193.8	-188.5	-169.7

[1]Data for fiscal 1984 and available quarters of fiscal 1985 are from *Survey of Current Business*, July 1985.

Whatever the right number is, there can be little doubt that an expenditure total in the range of $970-975 billion for fiscal '86 required putting a number of important budget items on paths that were both lower and less steeply sloped than had previously been the case. These surely include the defense budget and a number of domestic programs paid for through federal grants to state and local governments. To this extent, the initial resolve of the leadership of the 99th Congress paid off for fiscal '86. And to the extent that a number of programs have been placed on a permanently lower growth path, the budget savings will cumulate.

It is also clear, however, that the job of deficit reduction was not completed by the actions taken on the fiscal '86 budget. Deficit reduction will continue to occupy the Congress—both in connection with the fiscal '87 budget when that is addressed, and in connection with the administration's tax reform proposals which, according to most analyses conducted outside of the administration, appear to be revenue-negative rather than revenue-neutral. And it is apparently becoming increasingly clear to the Congress, the business community, and the public that tax increases are going to have to become a part of the permanent solution to the structural deficit problem.

As shown in Table 2, our budget assumptions for fiscal '86 are broadly consistent with the compromise budget enacted on the 2nd of August. In addition, we have assumed a similar-sized increase in total expenditure for fiscal '87 deriving from

- a 6 percent hike in defense spending inclusive of pay increases,
- a cap on nondefense purchases at the fiscal '86 level,
- further reductions in federal grant and subsidy programs, and
- a modified COLA indexing retirement benefits to inflation less 2 percentage points.

On the tax side of the fiscal '87 budget we have allowed for one change to existing legislation by placing a limit on the indexation of the personal income tax. Effective January

1, 1987, we have assumed that personal income tax rates will *not* be indexed for the first 2 percentage points of inflation. This tax increase, in effect for 3 quarters of the fiscal year, yields a revenue gain of $3.6 billion for FY'87.

Based on these budget assumptions, our forecast implies the deficit path shown as the bottom line of Table 2: a deficit of about $194 billion this fiscal year, followed by deficits of about $188 and $170 billion in fiscal '86 and '87 respectively. Thus, the continuation of spare increases in total federal spending—about 3½ percent per year—accompanied by only a modest tax increase, implies the ability to do just a bit better than keep a lid on the deficit. If expenditure growth of about 3½ percent per year requires *cutting* some programs to make room for rising debt interest, modest increases in certain programs such as defense, and virtually inescapable increases in *some* of the entitlement programs, it becomes questionable as to just how much longer the spending total can be kept to a growth rate anywhere near as low as 3½ percent.

We may well have the deficit under some degree of control for the next year or two, but we're far from having solved the deficit problem permanently. Significant further actions on the revenue side of the budget will be needed just to keep the deficit from turning back up a few years from now.

Monetary Policy, Interest Rates, and the Dollar

Based on quarterly averages, the interest rate on 3-month treasury bills bottomed out at 7.9 percent in 1982:4, just as the recession was ending. It had taken quite a deep and painful recession to bring these short-term rates down below 8 percent from their peak in excess of 15 percent in 1981:3. By the spring of '83—barely half a year into the recovery—interest rates were on the way up again, and 3-month treasury bills hit an average of 10.3 percent in 1984:3, immediately after the period of peak growth of real GNP. Interest rates moved sharply downward thereafter, and 3-month treasuries averaged just under 7½ percent in 1985:2, even dipping below 7 percent for a few weeks in late June and early July. Treasury bills haven't been that low since they averaged 7¼ percent in 1978:3 just prior to the second OPEC oil shock. The relationship of monetary policy to the recent pattern of interest rate movements can be seen through the data in Table 3.

After mid-1983, once it was clear that the economic recovery was firmly in place, the Federal Reserve System began to slow down the rate at which it was providing liquidity to the banking system. During the second half of 1983, the rate of growth of the monetary base fell 2.7 percentage points behind the rate of growth of total national expenditure (nominal GNP), and T-bill rates rose by 40 basis points. During the first half of '84, the Fed allowed the growth of the monetary base to fall even further behind the accelerating growth of national expenditure—a gap of 3.7 percentage points—and the T-bill rate went up by a full percentage point. The slowdown in expenditure growth in the second half of '84 and the Fed's near-closing of the gap between expenditure growth and base growth were accompanied by a one percentage point decline in the treasury bill rate. By the first half of this year the Fed was willing to go a good deal further in providing easier credit conditions. Voicing concerns over the growing problems of the export and import-competing sectors of the economy, and the possibilities of slow growth turning into no growth, the Fed permitted a sharp increase in the growth of the monetary base—4 percentage points in excess of expenditure growth—and the treasury bill rate dropped to a 7-year low.

TABLE 3. Expenditure, Money and Interest Rates: 1982:4 - 1985:2

Half-Year Period	Percent Change at Annual Rate		3-Month Treasury Bill Rate (%) in Terminal Quarter
	Nominal GNP	Monetary Base	
1982:4-83:2	10.4	10.4	8.4
1983:2-83:4	10.3	7.6	8.8
1983:4-84:2	12.8	9.1	9.8
1984:2-84:4	6.4	5.5	8.8
1984:4-85:2	5.1	9.1	7.5

The Fed's dilemma is clearly revealed in this brief review of recent changes in monetary policy. With a huge structural budget deficit, interest rates will be high on the average—either because an excess-demand-dominated economy raises inflation and interest rates, or because the Fed pushes up interest rates precisely to prevent an excess-demand inflation. The behavior of the Fed from mid-'83 to mid-'84 is consistent with the latter motive. If the high interest rates accompanying the restrictive monetary policy happen to push the value of the U.S. dollar up too sharply, the domestic economy is subjected to a "double-hit": the recessionary effects of both tight credit and a deteriorating net export position. When these conditions eventuate—as in the first half of this year—it is sensible to expect that the Fed will loosen up, but only temporarily. The fundamental problem remains the structural budget deficit. As long as that remains in place, we'll most often be in a relatively high interest rate position facing the potential of an overly-strong dollar and a weak industrial sector.

What of the near term? There is little evidence to support the position that the economy is about to return to boom-level growth rates. Excess-demand inflation is not a near-term problem, especially with imports running strong and the likelihood that federal government spending will be on the slow track for the next few years. The Fed, we believe, can continue with a reasonably accommodative monetary policy for the balance of this year, and well beyond that if the Congress and the adminstration can manage to agree on a scheme—including higher taxes—to chip away at the structural budget deficit. Washington didn't get that far in '85, but if the progress of this year is built upon and extended next year, there would be little reason to expect economic conditions to be developing in such a manner as to induce the Fed to shift to a much tighter credit policy.

For this forecast we have assumed that the Fed will gradually decelerate the rate of growth of the monetary base as U.S. economic activity begins to respond positively to lower interest rates and the declining dollar. We expect the Fed to be back to a path of 5 percent growth for the monetary base by early '86. In the context of our forecast this is consistent with a very gradual rise in short-term interest rates and a small further decline in long-term interest rates, which continue to adjust to lower inflation.

With interest rates continuing well below their levels of mid-'84 and the international currency markets faced with a huge supply of dollars resulting from our sharply rising trade deficit, the dollar is forecast to continue to slide: by

9 percent during the second half of this year, and by another 9 percent from the end of this year to the end of '86. In this context, we project an improving export picture. In real terms, our exports of goods and services are projected to rise at an annual rate of 3½ percent during the second half of this year, 6 percent during 1986, and at a 7 percent rate going into 1987.

Other Input Assumptions

Our principal assumptions regarding prices have to do with *farm and petroleum prices*. Most agricultural stocks are approaching record levels, and the near-term harvest outlook, both domestic and international, is strong. As a result we are assuming that farm prices will be stable for the balance of this year and will rise by 2½ percent during 1986 and by 3 percent (annual rate) thereafter. We anticipate only modest increases in crude oil prices over the horizon of this forecast, an annual rate of 2 percent or less.

With the dollar weakening steadily, we expect foreign suppliers of our *non-petroleum imports* to hold the line on their prices as denominated in own-currencies. On the average, we expect such prices to be rising at a rate of 3 percent during the coming year and a half. Given the dollar decline we are forecasting, this implies that non-petroleum import prices—in dollar terms—will be rising at an average annual rate of 11½-12 percent over the same period.

Summary of the Forecast

The main features of our forecast, as it results from processing the input assumptions already discussed through our econometric model, are summarized in Table 4.

The first column of Table 4 sets the stage by reviewing the progress of the economy during the first half of this year, as measured from 1984:4 to 1985:2. Although real final sales—the concept labeled World-Wide Demand for U.S. Production in Table 1—rose at a 2.4 percent annual rate from 1984:4 to 1985:2, real GNP grew at a tiny rate of only one percent as the rate of inventory accumulation dropped sharply from $16.8 billion (1972 prices) in 1984:4 to only $5.8 billion in '85:2. Further, nearly all components of aggregate demand rose at rates well in excess of the 2.4 percent growth rate of real final sales; the exception was real net exports, which were in deficit by $33.8 billion in 1985:2, up sharply from an aberrantly small real net export deficit of only $13.4 billion in 1984:4.

The overall performance of the U.S. economy is forecast to improve markedly in the second half of this year. Real final sales are forecast to be growing at a 3.2 percent annual rate as the real net export deficit rises minimally over the balance of this year. Residential construction activity is forecast to be up substantially as a result of the recent pattern of sharply lower interest rates. Real GNP is forecast to rise at a 4 percent rate—even more than real final sales—as inventory investment begins to recover from the sharp slowdown during the first half of this year.

With employment growth exhibiting some lag behind the recovery of output growth, we anticipate no improvement in unemployment during the next few months and project an unemployment rate of 7.4 percent for the closing quarter of this year. Inflation is forecast to remain well under control for the balance of the year, with the personal consumption deflator rising at an annual rate of 3½ percent from 1985:2 to 1985:4. The trade-weighted value of the U.S. dollar, on the other hand, is forecast to decline at an annual rate of 17 percent during the second half of this year.

Short-term interest rates are forecast to be steady at about current levels for the rest of this year, and long-term rates are expected to close the year at, or slightly below, current levels.

Real final sales are forecast to grow at a 3½ percent rate during 1986 and real GNP just slightly above that at 3.6-3.7 percent. Our real trade balance is forecast to be improving slowly during '86 as the dollar continues to decline, though at progressively diminishing rates, and U.S. income growth remains moderate. With production forecast to be growing at rates just above 3½ percent, the unemployment rate is expected to decline to about 7.2 percent by mid-'86 and then hold at about that level for the balance of the year.

Consumer prices, feeling the effects of relatively rapid increases in dollar-denominated import prices, can be expected to accelerate during 1986. But with farm and energy prices rising slowly, the speed-up in consumer price inflation—comparing the second half of next year and the second half of this year—is forecast to be only about one percentage point. We forecast that the personal consumption deflator will be rising at a rate of just under 4½ percent from 1986:2 to 1986:4.

As a result of our monetary policy assumptions and the stable and moderate growth pattern in the forecast, short-term interest rates are forecast to drift up slowly during 1986—only about 30 basis points from late '85 to late '86—and long-term rates continue to edge downward. There is no evidence of any financial crunch developing during 1986 and nothing in the forecast scenario either to generate any liquidity fears in the money markets or to induce a real tightening of monetary policy by the Fed. The sharp slowdown in federal expenditure growth is visible both in the low one percent real growth rate of total government purchases during 1986 and the first half of 1987, and the modest decline in the federal deficit to an annual rate below $170 billion in the first half of 1987. Recall, however, our earlier warning that the continuation of such a pattern of deficit reduction will begin to require even more difficult policy decisions—including the use of tax increases—during the budget-setting process in 1986 and '87.

Conclusions

There are four elements crucial to the forecast path presented in this report:

- relative to recent years, a major step-down in the rate of growth of federal expenditures for FY '86 and '87,
- further steps during the budget cycles of 1986 and 1987 to keep the structural budget deficit on a declining path beyond FY '87,
- the maintenance of a relatively easier monetary policy in exchange for the needed tightening of fiscal policy, and
- a consequent orderly depreciation of the U.S. dollar to permit some degree of recovery of our export- and import-competing industries.

That's a tall order. But it is fair to interpret recent events—the fiscal '86 budget compromise and its surrounding discussion, lower interest rates, the dollar's decline since February, and the heightened concern over the weakness of the U.S. manufacturing sector—as evidence that we're on or near the track of most of these crucial elements.

TABLE 4. Summary of RSQE Forecast

Economic Indicator	Actual 1984:4-1985:2	RSQE Forecast 1985:2-1985:4	1985:4-1986:2	1986:2-1986:4	1986:4-1987:2
Percent Changes at Annual Rate:					
Real GNP and Components (1972 dollars)					
Real GNP	1.0	4.0	3.7	3.6	3.1
Consumption	5.2	2.5	2.9	2.7	2.4
Durable Goods	8.6	2.2	2.0	2.5	1.3
Business Fixed Investment	5.8	5.9	6.8	6.6	6.4
Residential Construction	9.7	14.8	7.3	6.0	0.8
Government Purchases	2.1	2.7	1.1	1.0	1.0
Final Sales	2.4	3.2	3.5	3.5	3.0
Wages, Productivity and Prices					
Private Nonfarm Sector					
Hourly Compensation (1977 = 100)	4.3	3.8	4.6	4.6	5.0
Productivity (1977 = 100)	-1.3	1.7	2.1	2.4	2.1
Price Deflator (1972 = 100)	4.2	3.1	3.4	3.6	3.6
Personal Consumption Deflator (1972 = 100)	3.2	3.5	4.2	4.4	4.5
Exchange Rate Index (value of U.S. $) (1973 = 100)	2.5	-17.2	-10.4	-7.6	-5.3
Levels in Terminal Quarter:					
Civilian Unemployment Rate (percent)	7.3	7.4	7.2	7.2	7.2
Real Net Exports (billions of 1972 $)	-33.8	-35.8	-34.3	-31.3	-28.7
Automobile Sales (millions of units)	10.9	10.4	10.1	10.0	9.8
Private Housing Starts (thousands)	1770	1928	1960	2021	1989
3-Month Treasury Bill Rate (percent)	7.5	7.5	7.7	7.8	7.8
Aaa Corporate Bond Rate (percent)	11.6	11.0	10.8	10.6	10.6
Corporate Profits* (billions of $)	290.4	300.4	305.9	317.0	332.3
Profits as Percent of GNP	7.6	7.6	7.5	7.5	7.6
Federal Deficit (billions of dollars)	216.4	195.4	186.8	176.5	167.5

*Includes inventory valuation and capital consumption adjustments.

It's easy to spin out a number of bad-news scenarios corresponding to substantial policy failures. But they are well-enough known by most of our policy-makers as to limit severly the usefulness of that exercise; those few who don't know, simply wouldn't be convinced. Even our forecast—which *does* assume substantial satisfaction of these four crucial elements—produces nothing better than a 3½-4 percent growth rate during 1986 and implies no real reduction in unemployment, which stabilizes at about 7.2 percent for most of next year. The best current research on the topic pegs the economy's "natural unemployment rate" at 6-6½ percent, well below what we are likely to attain during the next few years. Past policy errors have consigned us to a long period of excess unemployment. We dare not miss the opportunity to continue to straighten out our macroeconomic environment. *August 1985*

Economic Self-Sufficiency among Recently-Arrived Refugees from Southeast Asia

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With the fall of Saigon in April 1975, the United States embarked on a program of resettlement of Southeast Asian refugees who now number approximately three-quarters of a million. Beginning in September 1978, a second major influx of refugees, including those Vietnamese and Chinese treated in the press as the "Boat People," began arriving in the United States. These more recent arrivals were moderately different in background characteristics by comparison with their earlier cohorts. While the earlier arrivials were largely Vietnamese who were educated, were familiar with Western culture, and possessed English language skills, those arriving in the fall of 1978 and after were more varied in ethnicity and their skills. In addition to Vietnamese, this second wave of refugees included Chinese from Vietnam, Hmong and Mien from Laos, Khmer, Lao, and others. On average they were somewhat less educated and more limited in job skills, education, and English proficiency.

In late summer 1982, the Institute for Social Research fielded a survey among Southeast Asian refugees who had arrived in the United States from October 1978. The primary purpose of this study was to determine the degree of economic self-sufficiency achieved by these refugees at the time and the factors associated with it. Three groups of refugees (Vietnamese, Chinese from Vietnam, and lowland Lao) were interviewed in five sites across the country: Boston, Chicago, Seattle, Houston, and Orange County, California. The interviewing took place in the depths of the American recession, and the economies of all the sites were suffering to one degree or another. The sampling was drawn from a combination of administrative lists and area probability sampling procedures.

CHART 1. Unemployment Rate by Length of Residence in U.S.

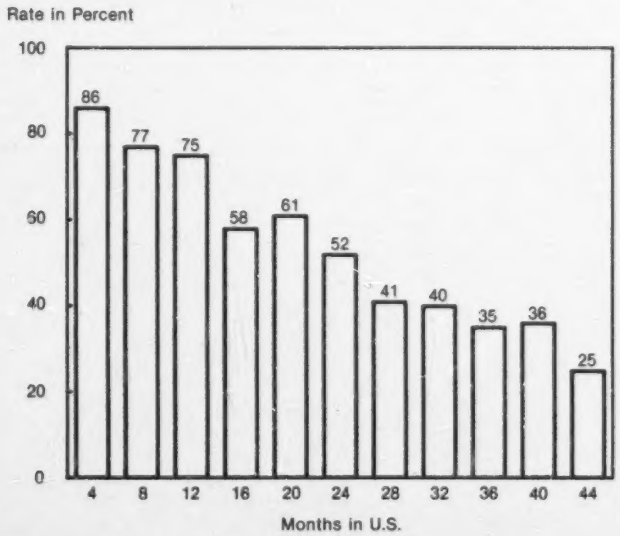
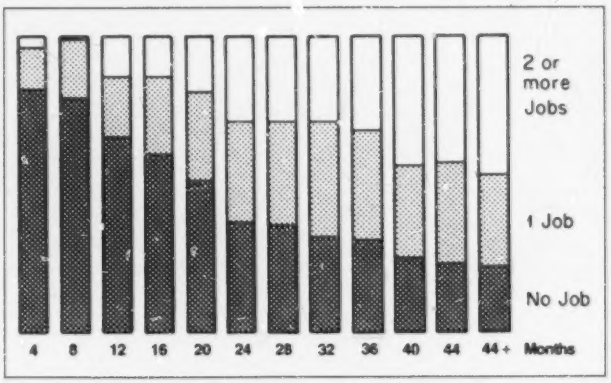


CHART 2. Employment per Household by Length of Residence in U.S.



The survey resulted in 1384 household interviews conducted in the respondents' native languages, yielding data on 4160 adults (aged 16 and over) and 2615 children. The adult population tended to be male (61 percent) and young, with an average age among adults of 31. The household (that is, all the individuals living therein) was focused upon as the unit of analysis. Our definition of economic self-sufficiency looked at two different aspects: whether the household had anyone within it receiving public cash assistance, and how the total income of the household (including both assistance and earnings) compared to the official poverty level.

Labor Force Participation

At the time of the survey, 44 percent (1823) of the total adult population were in the job market. The unemployment rate among these was 42 percent (773); 58 percent (1050) had found jobs. This figure does not include the 56 percent (2337) of the total adult population not participating in the labor force: those simply not looking for work (12 percent); students (24 percent); and housewives, the disabled, and the retired (20 percent).

While the unemployment rate is high, it is an aggregate figure which includes all refugees seeking work from the moment they enter the United States. Chart 1 shows the drop in the unemployment rate from the first months of resettlement (almost 90 percent) to residence for more than three years in the United States (about a third). Those refugees who had been in the United States between two and three years had an unemployment rate under 40 percent.

Of those who were working, about two-thirds held low status jobs in the peripheral as opposed to the core sector of the economy. The occupations in the United States were consistently lower in status than the occupations held in Southeast Asia, and there appears to have been little direct transfer of the skills employed in Southeast Asia to the jobs obtained in the United States so far.

The manner by which refugee households get ahead in the United States is by increasing the number of its occupants who are working and bringing in earned income—that is, by a multiple-job strategy. When seen from the standpoint of the household rather than the individual, a very different and far more encouraging picture emerges. Chart 2 shows changes in the percentage of the household sample with no job, one job, or two or more jobs over four month intervals. The steady, almost monotonic increase in the percent of households with two or more jobs is a most significant feature.

Income Source

Virtually all Southeast Asian refugees begin their American lives on welfare. For most, getting off public assistance is a slow and gradual process, one made more difficult by the relatively poor economy into which many of those surveyed were originally thrust. A majority of the households in our sample (65 percent) received some kind of cash assistance at the time of the interview; 45 percent in this country over three years still got some cash assistance (see Chart 3). Ten percent of the households were without any source of income. These were households that were either newly arrived and yet to receive cash assistance, or those in which the breadwinner was recently laid off.

We found three patterns of household income, according to the source of that income. The first pattern is transfer income—public assistance pure and simple; the second is a combination of public assistance (in whatever form) with earned income; and the third is earned income alone. A combined income for a household generally means that at least one individual is bringing earnings into the household at the same time that at least one other individual is bringing cash assistance into the same household. Occasionally, though rarely, the two cases might be the same person.

CHART 3. Households Receiving Cash Assistance by Length of Residence in U.S.

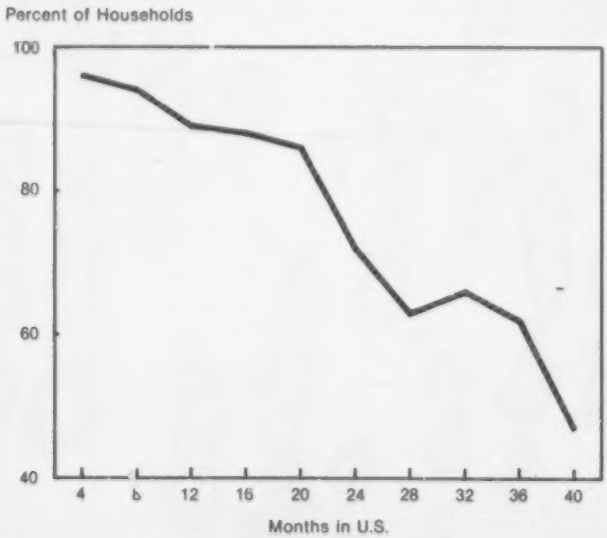
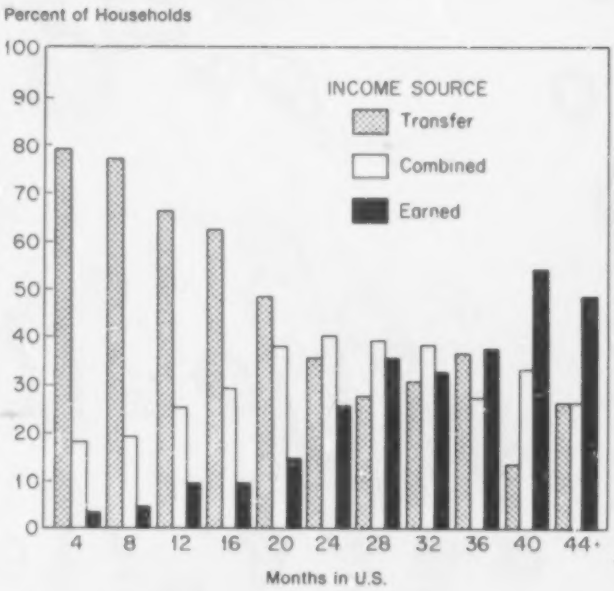


CHART 4. Income Source by Length of Residence in U.S.



Of the 1384 households surveyed, 42 percent subsisted solely on public assistance (whether cash or food stamps), almost a third (32 percent) combined earnings and some form of public assistance, and a quarter (25 percent) depended upon earnings alone. The importance of food stamps is illustrated by the fact that 94 percent of the households with only transfer income got them, as did 79 percent of the households with combined income sources.

Not unexpectedly, the refugee households with earned income alone were the earliest arrivals, having been in the United States an average of 32 months. They were also the highest in English proficiency and education upon arrival here. The households with combined income had been in the United States an average of 26 months, contained a higher percent of unrelated individuals, and were generally larger and more complex. The households totally on public assistance had been in the United States, on the average, only 20 months, were lowest in English proficiency and education on arrival, and were more likely to have come from rural areas in their homelands.

As the household members move from no jobs to one job and more enter into the labor force, there is a greater and greater chance for self-sufficiency. At the same time, there is an equally steady move from transfer to earned income, with or without a combined phase in between. Chart 4 shows the steady change, particularly in the first two years, for all three income groups. Households totally on transfer income dropped from almost 80 percent in the first four months to around 30 percent after three years. Those on earned income alone rose fairly steadily from 3 percent in the first four months to about 50 percent after three years. The

percentage of households with combined income rose from almost 20 percent in the first four months to double that from 20 to 32 months, before falling off to about 30 percent thereafter.

Poverty Level Standing

Fifty percent of the households sampled fell below the federal poverty level, and 8 percent had incomes at 50 percent or less of the poverty level. On the other hand, 20 percent had incomes which were at least twice the poverty level. The majority of households on transfer income were below the poverty line, while those with combined income tended to be just above the poverty line, and those with earned income alone were spread out well beyond the poverty line. Sixty-four percent of the transfer group, 28 percent of the combined group, and 12 percent of the earned group were under the line.

Although we have tended to view those on earned income alone as economically self-sufficient, it is somewhat misleading to do so. They are, in fact, economically independent, but the 12 percent below the poverty line cannot really be considered self-sufficient.

Once again, if we move from the aggregate data to a time line, we see a steady growth in the ability of the households to meet the poverty level and to go beyond it. The rise of households with earned incomes is matched by the rise in the percent of the poverty level met by the household income. Chart 5 shows that households in the United States only four months or less met 46 percent of the poverty level requirement, those here four to eight months met 95 percent, households here three years were close to 150 percent, and those here four years were almost at 200 percent. This change ties in with Chart 4 in poverty-level standing as well as with the number of jobs per household over time (see Chart 2). Thus, dramatic changes in economic status occur when additional people take jobs rather than from changes in wages through the job advancement of a single individual in the household. Seventeen percent of the households with no jobs were above the poverty level; 68 percent with one job and 93 percent with at least two jobs were above the poverty line. The rise in households with two or more jobs and the increase in the percent of poverty level met together confirm that improvements in living standards have resulted from additional people employed per household.

Factors Influencing Economic Self-Sufficiency

Household composition is strongly associated with the potential for improvement in economic position. Table 1 shows that the nuclear family, the household group which constitutes the largest proportion of the total sample (about half, in fact), has also had the highest percentage of those below the poverty line. Sixty-one percent of those households did not obtain enough income to meet this level. The second largest segment of the sample, households made up of extended families, was somewhat better, 43 percent being below the poverty level. The main element reflected in Table 1 is the number of employable adults available in each type of household. Thus, those households containing both related people and unrelated singles did significantly better than the same type of household without such attached singles, 25 percent being below the poverty line.

The *multiple-wage earner strategy* illustrated earlier in Chart 2 is of utmost importance to getting ahead economically. When one person gets a job the household's ability to meet basic needs over the poverty-level standard is improved. But the big change in living standard occurs when a second person from the household finds gainful employment. This is particularly important for the single nuclear family and demonstrates the importance of the multiple-wage earner strategies in the rapid adaptation to the labor force and in the achievement of early economic inde-

CHART 5. Percent of Poverty Standard Met by Total Household Income

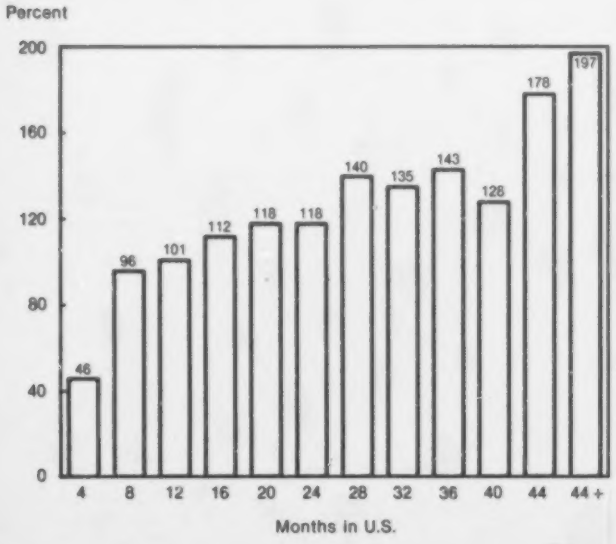


TABLE 1. Total Household Composition by Poverty Level

Household Composition	Percent of Sample	Percent with Income below Poverty Level
Unrelated Singles	5.5	9
Extended Family and Singles	4.8	20
Multiple Family and Singles	1.9	27
Nuclear Family and Singles	5.1	29
Single, Living Alone	4.7	29
Multiple Family	2.6	40
Extended Family	27.2	43
Nuclear Family	48.2	61
	100.0	

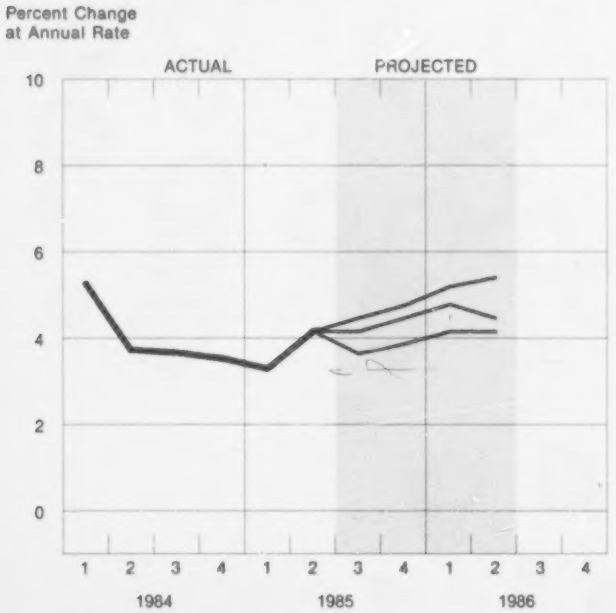
pendence; it also demonstrates the willingness of both spouses to participate in the workforce; and it carries with it a policy implication—namely, the likely importance of day-care for the economic advancement of low-income households.

English proficiency upon arrival in the U.S. is second only to household composition as a predictor of later self-sufficiency. For nuclear family households, it is the best predictor. Even minimal English proficiency beyond "none" greatly enhances the likelihood of achieving self-sufficiency. Yet, over half those sampled had no English proficiency upon arrival. Arrival English was a far better predictor than prior education, prior occupation, or current English. Thus, it did not matter how a person acquired English proficiency before arrival (i.e., educational or occupational background) nor how much or by what means proficiency was improved by post-arrival experience. The important predictor of economic self-sufficiency, at least during this early stage of resettlement, was proficiency upon arrival.

Long-Term Versus Short-term Economic Self-Sufficiency

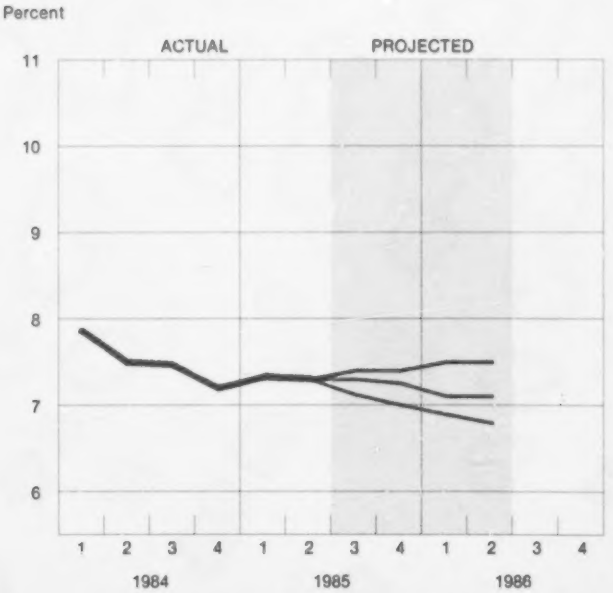
How long can the upward trajectory of economic progress indicated by these data be expected to continue? While the refugees may have been industrious and able to secure jobs which have moved them steadily out of poverty, the jobs held are primarily low in socioeconomic status and predominantly in peripheral rather than core sector employment. Thus, it is no wonder that 12 percent of the households on earned income are impoverished. Furthermore, the economic improvement has been due to multiple-job strategies and not because individuals advanced or secured better paying jobs. While they may have been successful in making ends meet, is there reason to believe that economic security or even well-being will follow? Put simply, the relationship between this rapid achievement of immediate self-sufficiency and the maintenance of long-term self-sufficiency remains to be seen.

CONSUMER PRICE INDEX



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Reappraising Social Security Fifty Years Later

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The Social Security Act recently celebrated its fiftieth anniverary. An omnibus law approved by President Franklin D. Roosevelt on August 14, 1935, it included nine different programs. Several of these became non-controversial and well accepted programs: federal grants to the states for maternal and child health, crippled childrens' aid, child welfare, public health, and vocational rehabilitation services. One program has become widely criticized but virtually unchanged: aid to families with dependent children (known widely now as AFDC but pejoratively called "welfare"). Federal aid to the states for the needy aged and needy blind (public assistance) was transformed (along with aid to the needy disabled enacted in 1950) into a federally financed and administered income- and resource-tested program in 1972 (Supplemental Security Income, SSI).

Social Insurance Programs

The two largest programs are "social insurance" mechanisms, also referred to as income maintenance programs, income transfer programs, or sometimes as income redistribution programs. They are the federal-state unemployment insurance system (UI) and the federal old-age, survivors, disability, and hospital insurance program (OASDHI). In recent years two other programs have been added to the Act: Medicaid (title XIX, 1965) and Social Services (title XX, 1972). The economic and fiscal impact of all these programs has been monumental. A "safety net" has been created which has provided a significant income stabilizer for the free market economy which is frequently overlooked.

These social insurance programs were enacted in 1935 largely with the intellectual support of the labor economists of the time and the anxiety and pressure from the Great Depression of 1929. Professors John R. Commons, Edwin E. Witte, Harold M. Groves, Paul Rauschenbush, and Elizabeth Brandeis Rauschenbush from the Economics Department of the University of Wisconsin played a major role in their formulation. Professors J. Douglas Brown of Princeton, Eveline Burns of Columbia University, and Paul Douglas of the University of Chicago were among the supporters of the social insurance proposals along with many social workers and propagandists for social reform (such as I.M. Rubinow and Abraham Epstein).

Proposed "Reforms"

In the intervening years some of the new economists on the scene have tended to be more critical of social insurance, its concepts, provisions, and objectives, and have suggested changes, reforms, or alternatives. The first criticisms tended to have specific targets: it was not "insurance" as they defined it, the employer payroll tax was regressive and borne by the employee, the reserves were either too big or too small, the "retirement" provisions encouraged individuals to stop working, insurance payments to unemployed persons increased unemployment, payroll taxes tended to encourage mechanization, etc. In the course of time the younger economists came forth with new proposals to supersede or modify the programs designed by the progressive and populist labor economists of the 1920s and 30s.

Among the major reforms of social security (OASDHI) advanced by critics of the system are the following:

1. Apply an income test to benefit recipients and thus reduce the cost of Social Security by reducing or withdrawing benefits if income or assets exceed a certain level.
2. Make Social Security contributions voluntary or give individuals an option to invest their contributions in approved mutual funds.
3. Separate the benefits into two parts: a basic "general welfare" payment paid out of federal general tax revenues and a supplemental contributory "insurance" benefit, i.e., a "double decker" benefit program that would reduce the cost from payroll taxes but require an increase from federal income or other taxes.
4. Increase the retirement age to 68 or 70, and eventually to 72 or 75, and thus reduce costs by reducing the number of beneficiaries.
5. Separate Medicare from the Social Security program and increase the deductibles and co-insurance to shift part of the cost back to the individual when he or she is sick.

Still other big and little changes have been proposed, but the five mentioned above give a good idea of the range of the proposals. I do not favor any of these changes. While each has some value, each also has disadvantages which, in my opinion, outweigh any advantages. Such reforms tend, in my judgment, to undermine people's confidence in the stability and permanence of the system. They rock the boat in people's minds—especially the very old and those with the lowest incomes.

Whatever the merit of the criticisms and of the options, the voice of the economists has fallen largely on deaf ears of legislators and the public. Marginal modifications have taken place, especially in 1983, but they were not fundamental. The Reagan proposals of May 1981 to cut back on benefits were rejected. Many business economists and budget cutters proved to be out of step with the general public. Franklin D. Roosevelt had turned out to be a better prognosticator of the stability of the programs than the newer macroeconomists and econometricians. The earlier economists prided themselves in being part of a noble and

*Wilbur J. Cohen graduated in labor economics in 1934 from the University of Wisconsin. A student of Professors Commons, Perlman, and Witte, he went to Washington to assist in the formulation and administration of the Social Security program (1934-1955). He became a professor at the University of Michigan (1955-1980) with a period of leave during which he served as Secretary of Health, Education, and Welfare in the Johnson cabinet (1968). He is Professor and Dean Emeritus and Distinguished Senior Scholar in Policy Studies, University of Michigan-Wayne State University Institute of Gerontology. He is currently Professor of Public Affairs at the L.B.J. School of Public Affairs at the University of Texas at Austin (1980-).

broad profession including aspects of political science and sociology. But the voice of economists in recent years has become more pertinent to such issues as federal and state budgets and taxes, foreign trade, and forecasting; and their role in social insurance policy formulation and revision has been less significant.

Of course, there have been notable exceptions: Alan Greenspan, Henry Aaron, James Tobin, Robert J. Lampman, Bruno Stein, Alice Munnell, and Joseph Pechman are current examples of influential economists who have maintained a continuing relationship with the basic concepts and provisions of social insurance as defined by the earlier generation even though they suggest some changes. They stand in sharp contrast to persons like Milton Friedman, who revels in his fundamental attacks on social security and welfare.

Objections to "Reforms"

My purpose here is not to refute each of the five proposals listed above. It is, rather, to state some general objections I have to such reforms. My vision of Social Security is as a basic floor of protection for all persons, upon which they can build greater protection for themselves. Such a system encourages individual and group saving and stimulates private plans to supplement the basic protection.

Some of the proposed changes to reduce long-range benefit costs of social security arise from a belief that we will not long be able to afford the program in its present form because more people are living longer. This belief seems to me to be based on the assumption that the American economy is going into a permanent state of slow economic growth or "stagflation," and thus that we can no longer afford to be as generous as we thought we could be.

I do not share the current pessimism about our economic future for several reasons. I believe that increased productivity will continue to be a feature of the American economic system. We will ultimately survive the pessimism of the 1970s and 80s and reach a more prosperous "high-tech" period. We should not make radical long-run changes in social security based upon dismal short-run economic forecasts. These changes could adversely affect the security, the planning, the expectations, and the benefits of present contributors to the system. Although the number and population of aged Americans will increase in the years to come, it appears that the percentage of children in the population will not. As a result, the ratio of total dependents (those under age 20 plus those age 65 and over) to the rest of the population will remain relatively reasonable (see Chart 1).[1] Thus the overall financial burden on society for the care of total dependents should not increase as much as just looking at the aged alone implies. In addition, if our gross national product continues to grow (as I believe it will), the total cost of OASDI should not increase very much as a percentage of the gross national product. It is currently about 5% of GNP and may reach 6% by the year 2035 (see Chart 2).[2]

The one exception to this generalization is likely to be medical care costs, not only for the aged but for the entire population. This involves different considerations from the cash-benefits part of the program. Cost constraints on rising medical costs *are* essential. All the available indicators suggest that the old age, survivors, and disability cash benefits of the program do not require any cutbacks. The 1983 amendments put them on a soundly- and adequately-financed path for the long run. It is the Medicare program, however, that requires financial attention due to the rapidly increasing costs of medical services. In 1985, individuals will pay 1.35 percent of their wages and salaries and employers will pay an equal percentage, totaling 2.7 per-

[1]Estimates of the total dependency ratios from 1960-2060 can be found in the *1984 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, April 5, 1984, House Doc. 98-200, 98th Congress, 2d Session, p. 85. Three different sets of assumptions are made. In 1960 the ratio was 91.5% of the working age population, 20-64. It is never estimated to be this high under alternatives one or two and not to reach 92% under alternative three until the year 2050.

[2]For estimates of cost of the OASDI program as a percentage of GNP, 1984-2060 by alternatives, see *Ibid.*, pp. 76-77.

CHART 1. Dependency Ratios of Older and Younger Persons to Working-Age Population, 1965-2055

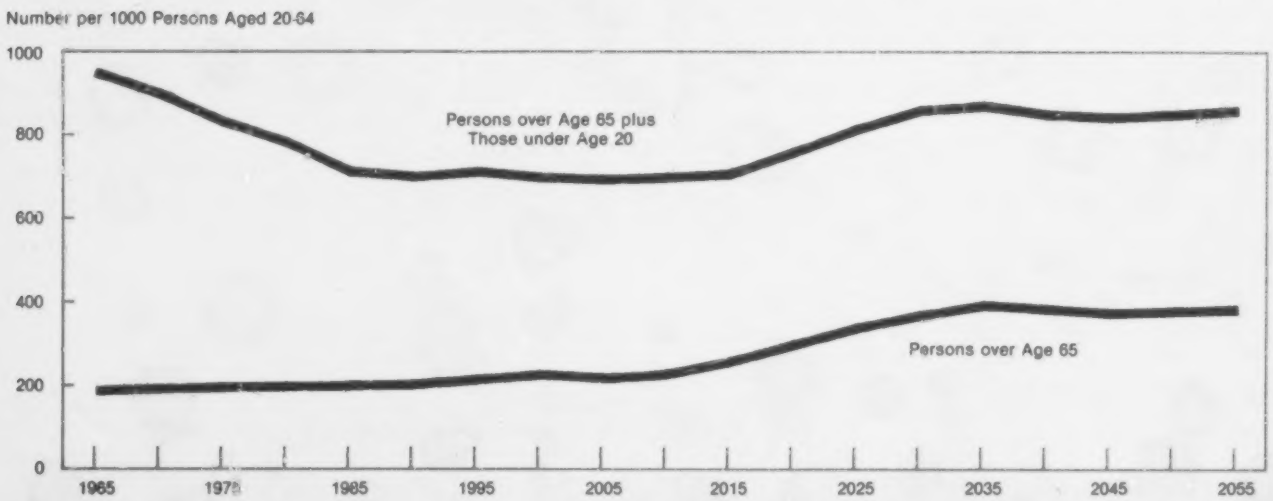
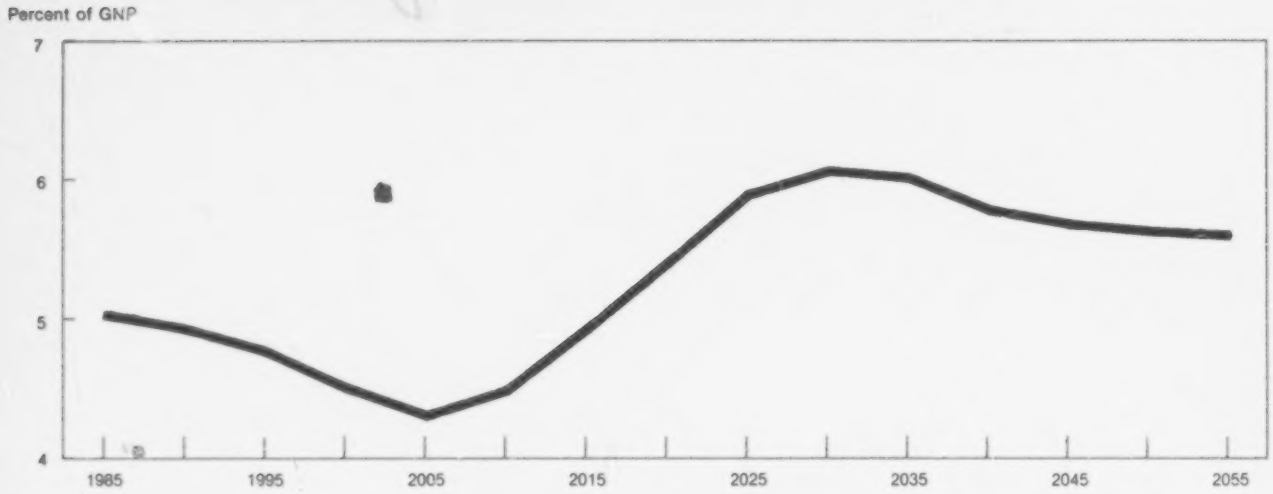


CHART 2. OASDI Outgo as a Percent of GNP, 1985-2055



cent, for Medicare. This will amount to about 19 percent of the contribution income to the Social Security program as a whole.

The Medicare allocation is already scheduled to increase to 1.45 percent each in 1986. Nevertheless, with medical costs continually increasing, it may still be necessary to allocate additional funds for Medicare to keep the program financially sound. While I would favor some additional financial resources for Medicare if they are needed, the more basic need is for an effective nationwide cost-constraint program to keep medical costs from rising as fast as they have in the past.

It is very probable that overall medical expenditures will continue to rise as older people live longer, and because terminal illnesses can be so expensive. The ongoing development of technological devices for medical diagnosis and treatment is also an important factor in the continual increase in medical expenditures. We must find better ways to control medical costs, but we must also be prepared to pay more for the medical miracles that will most likely continue to evolve.

The most widespread suggestion for short-run reform concerning Social Security's cash benefits involves cutting back on the cost-of-living adjustment (COLA). Several proposals have been advanced: freeze the COLA for one year; reduce the COLA by one or two percentage points; base the increase on changes in prices or wages, whichever is lower; pay a uniform amount, instead of a percentage increase. These proposals are all predicated on the belief that they would help to reduce the federal deficit. I oppose reductions in the COLA as part of a policy for reducing the federal deficit. Social Security contributions are presently yielding an excess of revenue over expenditures. The Social Security program is not a cause of the federal deficit, and it should not be politicized in this way.

Administrative Considerations

Moreover, Social Security revenues and benefits should be excluded from the federal unified budget as soon as possible. Most people do not consider Social Security, financed by earmarked payroll taxes, in the same sense as national defense or general governmental expenditures. As a matter of fact, the law provides that Social Security will be excluded from the federal unified budget in 1993. I think it would greatly assist in public understanding and policy decision making if this change were made effective in 1986.

Along the same lines, I also favor reestablishing the Social Security Administration as an independent board so that it will be administered in a non-partisan manner. Since 1939, the Social Security Board, and later the Social Security Administration, has been part of a large federal department, currently the Department of Health and Human Services. I think most people want to have Social Security considered separately, apart from political and budgetary considerations and apart from national defense or general tax policy issues.

Equity Considerations

People get their money's worth from Social Security if they look at their contributions and benefits (or potential benefits) in terms of the protection they receive.[3] None of us knows how long we are going to live, whether or when we will become sick or disabled, or when we will want or have to retire. We do not consider our premiums for fire insurance on our homes to be wasted or unfair if our houses never burn down, even though we may never claim a penny in benefits.

Similarly, some people will receive back in cash Social Security benefits more than they paid in, and some less. This doesn't make the Social Security system unfair. It is the potential lifetime protection that is valuable. And all this is accomplished at the remarkably low administrative cost of less than 1.5 percent of contributions.

[3]For substantiation that individuals receive their money's worth from social security, see Robert J. Myers, *Social Security* [Third Edition], Richard D. Irwin, Homewood, Il., 1985, p. 306-8, 462-65, 478-83. Myers was Chief Actuary of the Social Security Administration for many years.

It should be kept in mind that only about 58 percent of contributions are used for old age benefits. About 16 percent go for survivors' benefits (monthly life insurance); about 7 percent for disability benefits; and, as mentioned earlier, 19 percent for Medicare. One must look at the whole package of benefits, over an entire lifetime and for a large group of persons, to appreciate the substantial protection the system affords to individuals who have a variety of needs and experiences.

When individuals contribute to Social Security, they do so because they are making an earmarked contribution for a specific set of protections. But we must also view Social Security in the context of a dynamic nation's economic and social needs. Social Security should be viewed as a compact between contributors and their government, as the instrument for carrying out their expectations for a range of lifetime protections—not merely as old age retirement insurance. Social Security includes medical services under Medicare and economic protection for young widows and children, and for middle-aged disabled persons. It is a form of family and life-time protection, not a savings bank system or an endowment policy. It is an intergenerational compact, between younger workers and their parents and grandparents, that protects the family from dependency and fear.

I can visualize a different kind of social security system that could be more advantageous to wealthy persons, or another kind of system that could be more adequate for poor persons. I can visualize a system that could cost less or cost more or could be more generous or less generous. But all in all, the present program is a reasonably equitable and efficient one for a country as large and diversified as the United States, with people of such varying views regarding such issues as equity, efficiency, and adequacy. I doubt whether a radically different sysem would meet with universal approval of the electorate or with any greater support or less criticism than the present program.

Conclusions

I am one of those who believes that Social Security will be around when my grandchildren retire in the year 2050 or so. By that time I think there will be more career, educational, and leisure opportunities than my generation or my parents' generation enjoyed. I also believe that as long as the United States remains a political democracy in which the individual can freely vote, people will not allow their representatives in Congress to repeal, mutilate, or destroy the fundamental objectives and provisions of the Social Security program.

Today the social insurance provisions of the Social Security Act are big business. When other private and public pension, health, and welfare programs are included, the total easily reaches 20 percent of the GNP.

The implications of these big figures are discussed in economics courses on macroeconomics, public finance, or budget management. But the old-fashioned courses on labor economics and social policy, which dealt with the history of social and economic reform, income redistribution, and social legislation, are no longer taught. Economic students today have little or no emotional interest in social reform as did the economists of 50 years ago.

The young students of today are more interested in careers in business, finance, and law rather than public service or social reform. Their "me, too" philosophy is in sharp contrast to the populism, social reform, and idealism of the economists of the 1930s. A large number of young people do not believe social security will be around when they retire.[4] The social and economic gap between higher-income and lower-income people has widened, in my opinion, and bodes ill for our people. As educational attainment increases, the population becomes more conservative politically. The gap widens between the poor and the affluent.

This is not the place to consider complex and controversial proposals to resolve all these difficulties. It is, however, a plea for economists in business, government, and the universities to reappraise their larger role in our society and economy in improving the institutions which undergird them.

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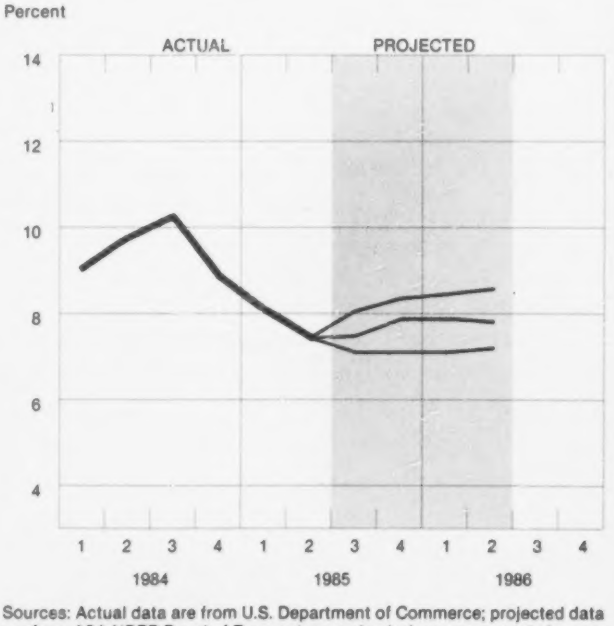
[4]In a public opinion poll taken in the spring of 1985, 35 percent of those aged 25-34 replied that it was "very likely" that social security payments would no longer be given "when I retire"; 40 percent more thought it "somewhat likely." But 56 percent said social security was one of the very most important programs of government, and an additional 40 percent said it was "an" important program. *A Fifty-Year Report Card on the Social Security System*, A National Survey conducted by Yankelovich, Skelly and White, August, 1985.

Editor's Note: The Survey Research Center's James N. Morgan will present his comments on and suggestions for the Social Security system in the next issue.

3-MONTH TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	83:4	84:1	84:2	84:3	84:4	85:1	85:2	85:2	85:3	85:4	86:1	86:2	1984	1985	1986
GROSS NATIONAL PRODUCT	3,432	3,553	3,645	3,695	3,759	3,811	3,855	3,886	3,966	4,040	4,119	4,188	3,663	3,928	4,204
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	218.2	220.6	222.4	224.6	226.1	229.1	230.6	231.0	233.3	235.7	238.4	241.0	223.4	232.3	241.8
CORPORATE PROFITS AFTER TAXES	141.1	150.6	150.2	141.7	141.0	137.0	136.5	143.0	146.0	149.0	152.9	153.7	145.9	144.0	152.0
UNEMPLOYMENT RATE (percent)	8.47	7.87	7.50	7.47	7.20	7.33	7.30	7.20	7.20	7.15	7.00	7.00	7.51	7.20	7.00
INDUSTRIAL PRODUCTION* (index, 1977 = 100)	114.9	119.3	121.4	123.3	123.1	123.8	124.4	124.6	126.1	127.6	128.3	129.1	121.8	125.3	129.1
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.716	1.947	1.858	1.663	1.598	1.795	1.769	1.850	1.827	1.800	1.790	1.760	1.766	1.800	1.775
CONSUMER PRICE INDEX (% change from prior quarter or year)	4.11	5.29	3.74	3.67	3.54	3.30	4.17	4.00	4.00	4.30	4.60	4.30	4.28	3.70	4.20
3-MONTH TREASURY BILL RATE (%)	8.79	9.13	9.84	10.34	8.97	8.18	7.52	7.75	7.80	8.20	8.20	8.13	9.57	7.95	8.20
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	12.76	12.94	14.18	13.72	12.63	12.57	12.15	12.05	12.23	12.15	12.20	12.20	13.37	12.20	12.20
GNP IN 1972 DOLLARS	1,573	1,611	1,639	1,645	1,662	1,664	1,672	1,680	1,700	1,712	1,720	1,733	1,639	1,690	1,739
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	1,032	1,044	1,064	1,066	1,075	1,089	1,103	1,098	1,106	1,115	1,123	1,130	1,062	1,102	1,133
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	184.5	193.3	202.9	209.5	213.8	213.0	219.0	219.0	222.0	224.0	227.0	230.0	204.9	220.5	231.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	57.8	60.6	60.8	60.1	59.2	60.0	60.8	61.0	62.7	62.6	62.0	61.2	60.2	62.0	61.6
CHANGE IN BUSINESS INVENTORIES (1972 $)	7.2	31.6	20.3	30.6	16.8	19.1	8.3	16.2	17.0	17.0	16.5	16.0	24.8	17.7	16.0
NET EXPORTS (1972 $)	2.0	-8.3	-11.4	-27.0	-13.4	-28.4	-33.3	-27.0	-28.0	-29.0	-30.0	-29.4	-15.0	-27.9	-29.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	113.0	112.2	123.2	125.0	129.6	129.8	129.8	131.0	132.0	134.0	135.0	136.0	122.5	131.2	136.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	175.8	177.3	178.9	181.1	180.9	180.9	183.7	183.0	184.0	185.0	186.0	187.0	179.5	183.1	187.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	82:3	82:4	83:1	83:2	83:3	83.4	84:1	84:2	84:3	84:4	85:1	85:2	1982	1983	1984
GROSS NATIONAL PRODUCT	3,080	3,110	3,174	3,267	3,347	3,432	3,553	3,645	3,695	3,759	3,811	3,855	3,069	3,305	3,663
PERSONAL CONSUMPTION EXPENDITURES	2,001	2,046	2,070	2,142	2,181	2,230	2,277	2,333	2,361	2,396	2,446	2,498	1,985	2,156	2,342
GROSS PRIVATE DOMESTIC INVESTMENT	415.3	376.2	405.0	449.6	491.9	540.0	623.8	627.0	662.8	637.8	646.8	640.9	414.9	471.6	637.9
NET EXPORTS	6.6	6.3	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-56.0	-74.5	-93.4	19.0	-8.3	-64.2
GOVERNMENT PURCHASES	656.3	681.0	678.8	682.2	689.8	691.4	704.4	743.7	761.0	780.5	791.9	810.1	650.5	685.5	747.4
DISPOSABLE PERSONAL INCOME	2,196	2,238	2,261	2,303	2,367	2,429	2,502	2,554	2,606	2,645	2,655	2,728	2,181	2,340	2,577
PERSONAL SAVING RATE (% of disposable income)	6.1	5.8	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.2	4.5	5.0	6.2	5.0	6.1

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late August, and projected data, released by ASA-NBER in June, are displayed for second quarter 1985.

Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

*Substantial revision of the data for variables marked with an asterisk has occurred since the last printing.

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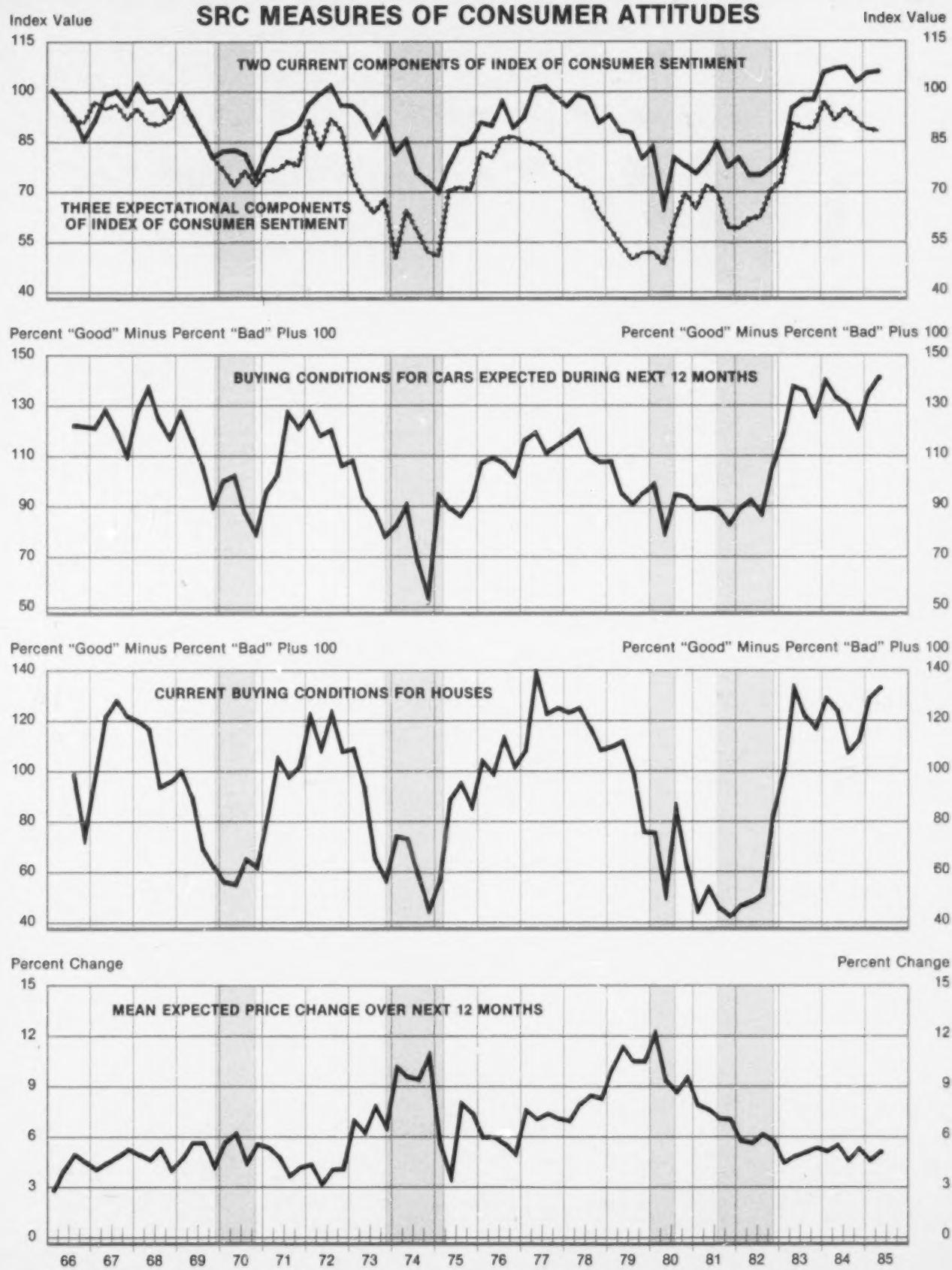

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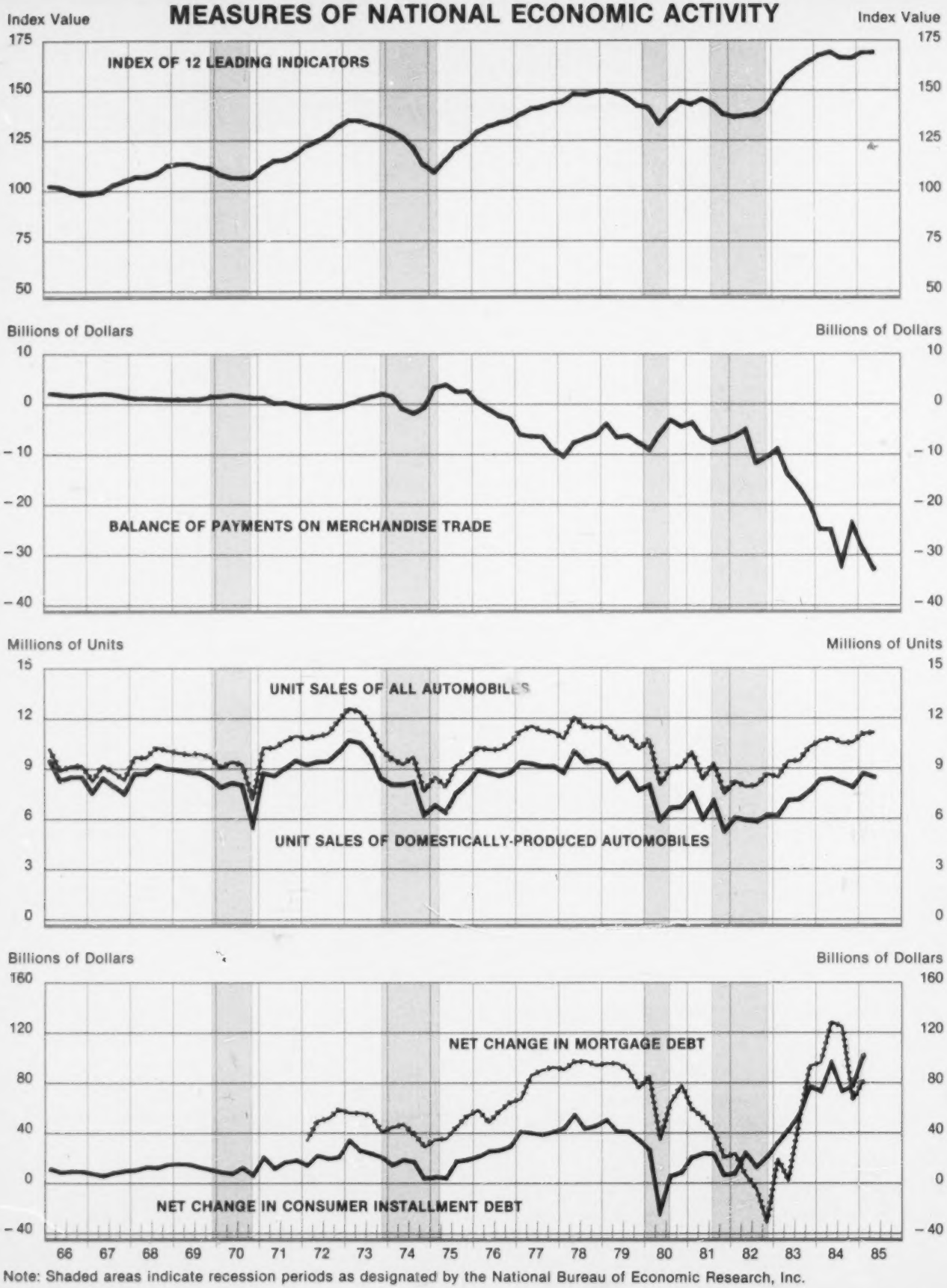
MEASURES OF NATIONAL ECONOMIC ACTIVITY



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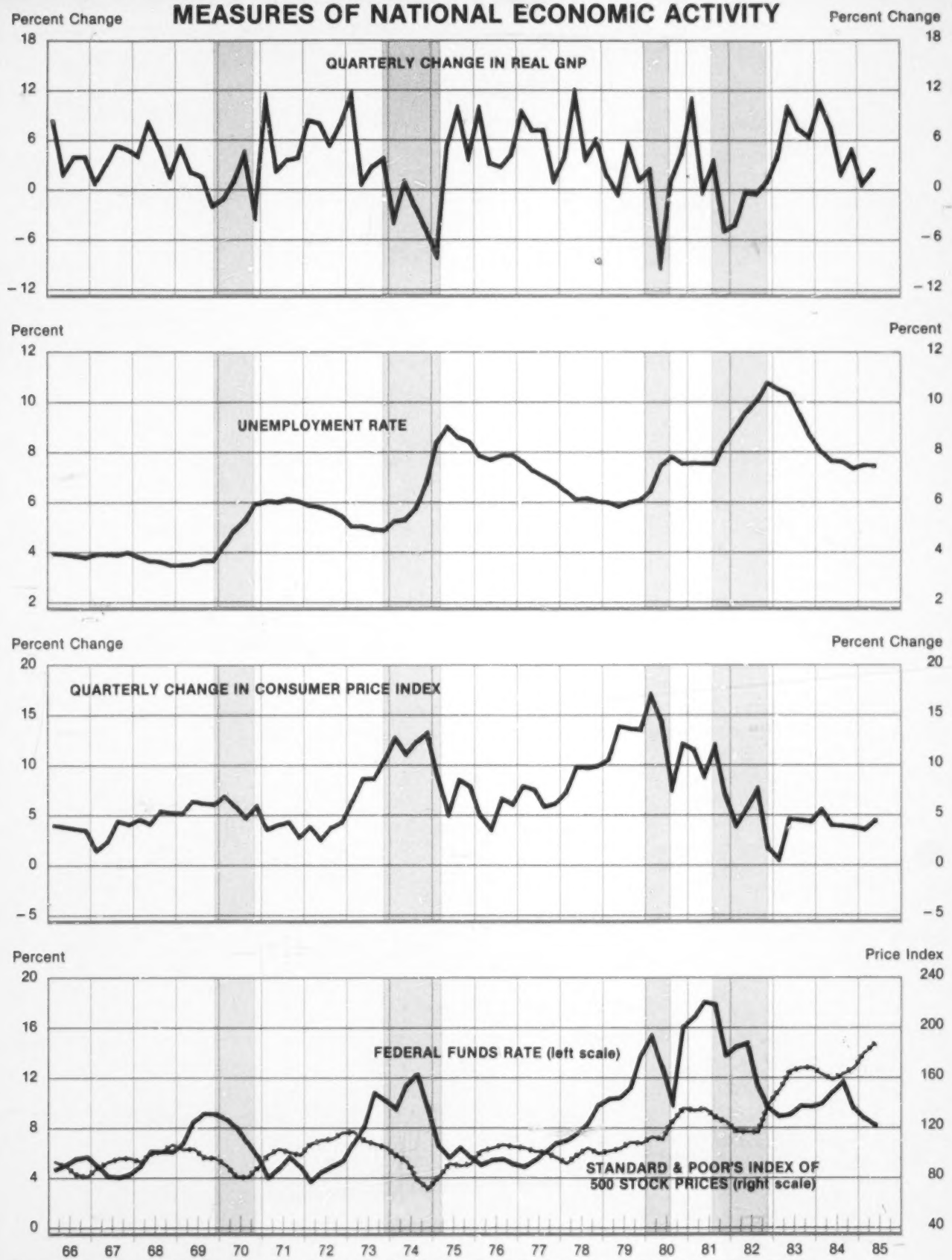

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